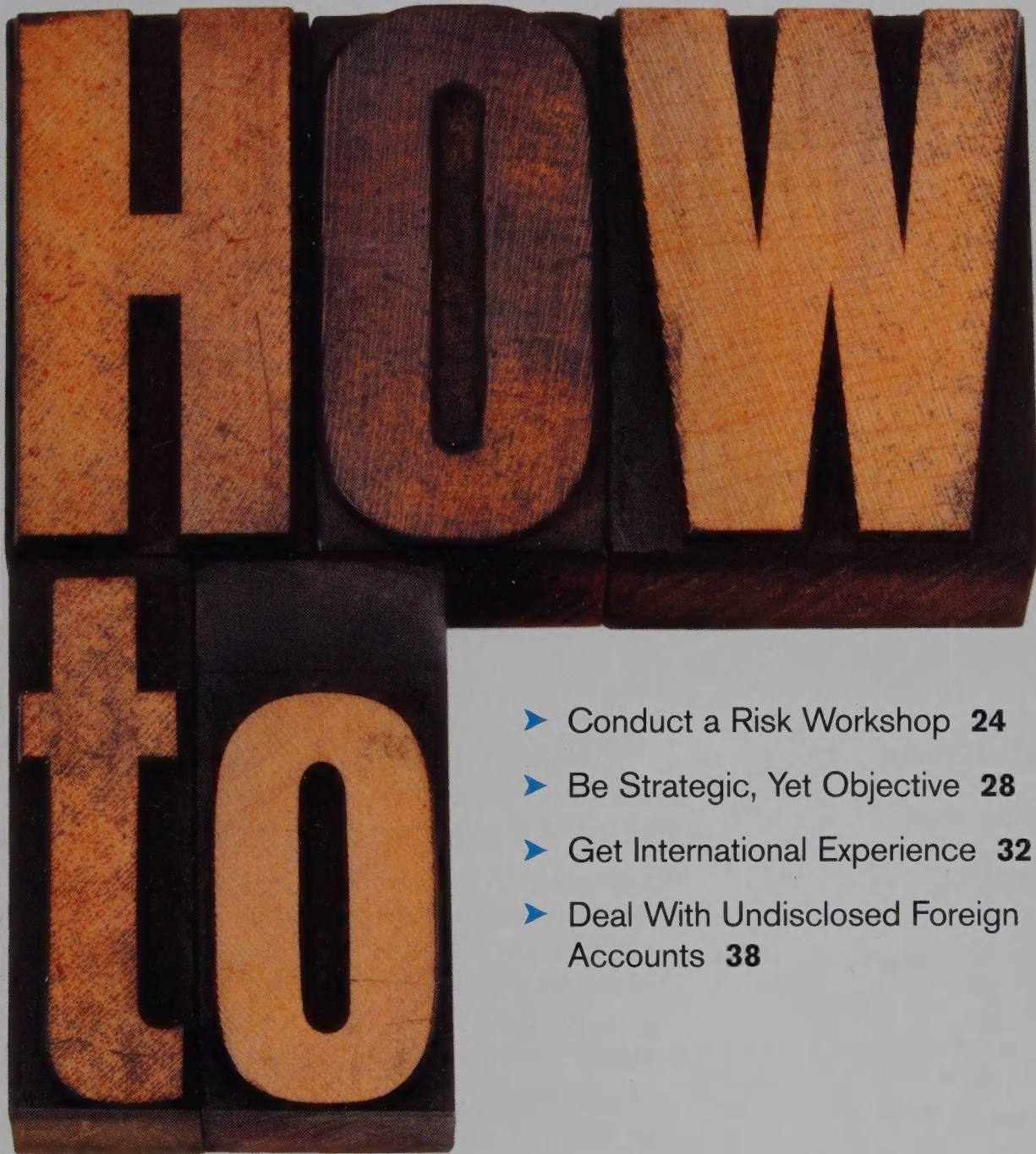


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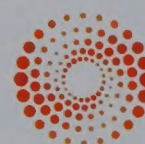
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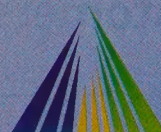


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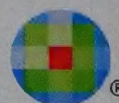
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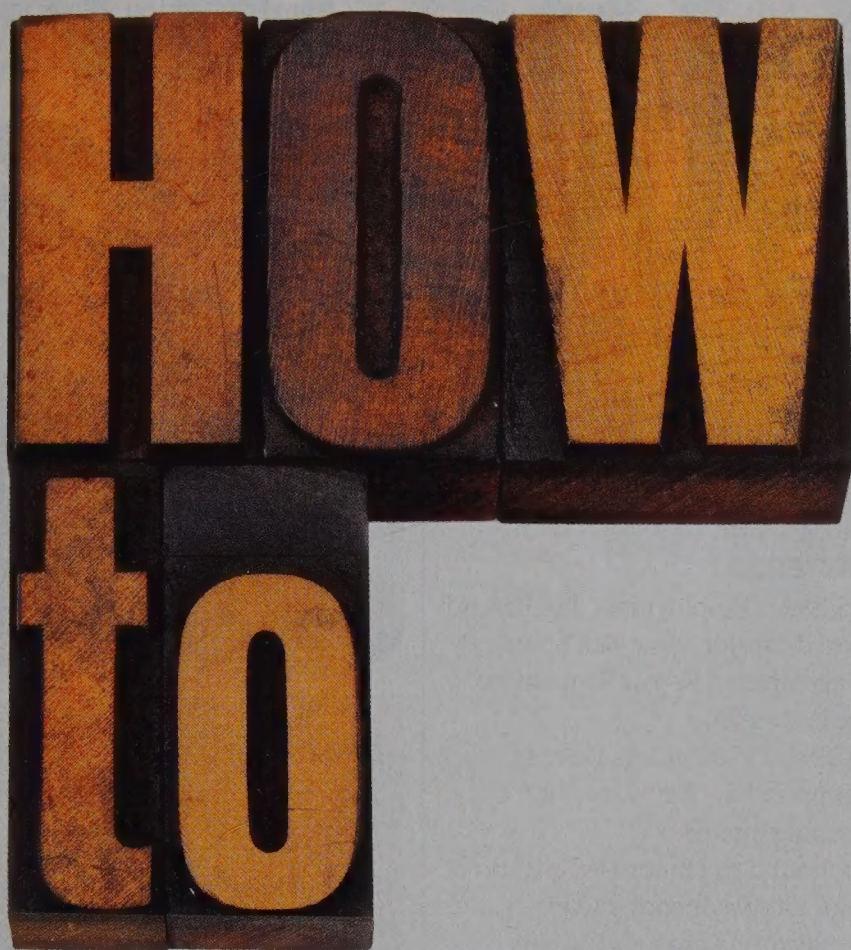
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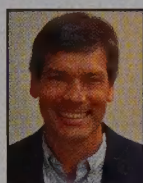
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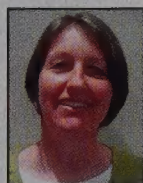
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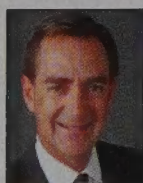


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■ **Seven Steps to Closing a Succession Sale** (cont.)

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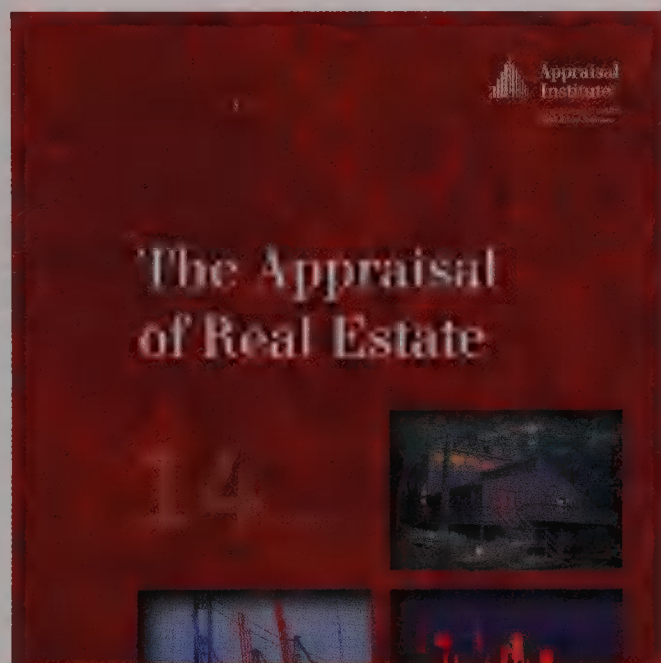
■ **Higher Stakes for Tax Treatment of Rental Real Estate** page 56



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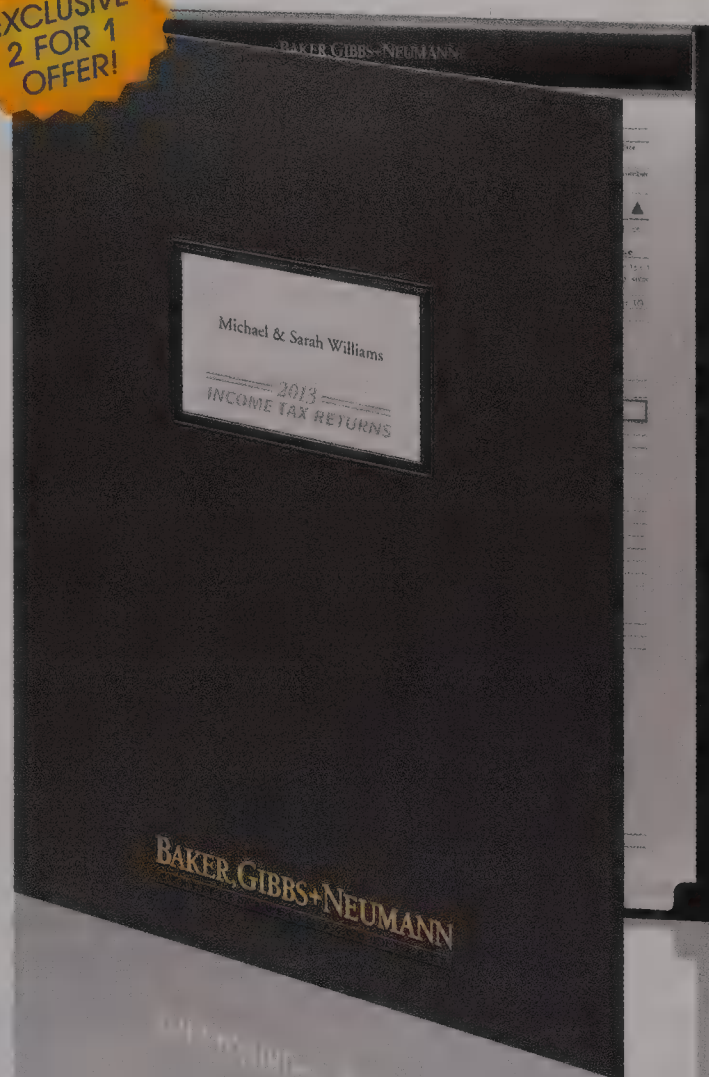
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AUDITING

■ The PCAOB approved new standards for auditors of brokers and dealers.

Two new attestation standards are designed to help protect customer funds by establishing rules for examinations and reviews of compliance information that broker-dealers submit to the SEC.

A new auditing standard applies to procedures performed and reporting on supplemental information that brokers and dealers file with the SEC. The board also adopted related amendments to other PCAOB standards.

The standards were enacted in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act, P.L. 111-203, which authorized the PCAOB to oversee audits of brokers and dealers registered with the SEC. Previously, the generally accepted auditing standards of the AICPA Auditing Standards Board governed broker and dealer audits.

If approved by the SEC, the standards and amendments will take effect for services performed for fiscal years ending on or after June 1, 2014. The standards are available at tinyurl.com/ljlwypy and tinyurl.com/m8n73af.

AICPA President and CEO Barry Melancon, CPA, CGMA, issued a statement saying the AICPA has been consistent in its position that brokers and dealers should be subject to SEC regulation, and that auditors of brokers and dealers that carry, clear, or have custody of customer funds should be subject to the PCAOB's standards, inspections, and enforcement programs.

Melancon said it is critical that the PCAOB use risk analysis in determining which audits of broker-dealers should be included in a permanent inspection program that will be implemented by the board.

"We urge the board to act expeditious-

HIGHLIGHTS

■ The converged FASB/International Accounting Standards Board (IASB) proposal on financial reporting for leases faces significant opposition from businesses around the globe.

An analysis of comment letters on the proposed standard submitted by business and industry respondents that would be considered financial statement preparers (excluding accounting firms) revealed substantial opposition to the proposal.

Of the 268 letters analyzed, 212 expressed a decidedly negative opinion of the proposal, which would place leases on the balance sheet and create a dual-recognition model for lessees. Just 25 letters indicated substantial support for the proposal, and 31 letters did not express a clear positive or negative overall opinion of the proposal. Additional letters continued to be posted to FASB's site following the analysis.

The objections from businesses came from various industries and nations:

- China Telecom said the standard is difficult to understand, apply, and implement, and that the differences between lessor and lessee accounting are logically unsound.
- Wesfarmers Limited, one of Australia's largest listed companies with operations in retail, mining, insurance, chemicals, and energy, said IAS 17 should be retained for leases because on-balance-sheet recognition of leases (including property) is conceptually inconsistent with the accounting treatment of economically similar arrangements.
- Delta Air Lines noted that former IASB Chairman Sir David Tweedie once said that one of his ambitions is to fly in an aircraft that is on an airline's balance sheet. But Delta concluded that although the ED is consistent with Tweedie's objective, the benefits of this particular proposal do not outweigh the costs.

(Continued on page 13)

ly in determining the scope of that program," he said.

The PCAOB, which is operating an interim inspection program, anticipates presenting a rule proposal for a permanent inspection program in 2014 or later.

■ Companies in the U.K. FTSE 350 will be required to place their audit contracts out for bid every 10 years under new rules announced by the U.K. Competition Commission (CC).

The rules represent a softening of the five-year mandatory retendering proposed earlier by the CC. Some businesses and regulators, including the U.K. Financial Reporting Council (FRC), voiced opposition to the five-year retendering proposal.

But the CC's rules are stronger than

those imposed in 2012 by the FRC, which merely required companies that did not go to tender every 10 years to explain their reasons for not retendering.

The CC said in a news release that it is aware that its rules may be affected by audit reform measures the European Union (EU) is considering. But the CC said it is acting based on the evidence of its own investigation in the absence of definitive EU proposals. The CC said it will be able to amend its rules, if necessary, if the EU agrees upon measures. The EU is considering a possible mandatory audit firm rotation requirement.

The CC also will require that the FRC's Audit Quality Review team review every audit engagement in the FTSE 350 every

five years, on average; prohibit Big Four-only clauses in loan agreements; require a shareholder vote at the annual meeting on whether audit committee reports in company annual reports are satisfactory; and strengthen the accountability of the external auditor to the audit committee and reduce management's influence.

FINANCIAL REPORTING

■ Three new standards the AICPA Accounting and Review Services Committee (ARSC) voted to propose are designed to help practitioners clearly distinguish between preparation and reporting services.

ARSC voted to expose for public comment proposals titled *Preparation of Financial Statements*, *Compilation Engagements*, and *Association With Financial Statements*. Comments will be accepted through May 2, 2014. The ED is available at tinyurl.com/o794byc.

The proposed compilation standard was revised after feedback suggested substantial changes from an ED issued last year. The revised standard would apply when the accountant is engaged to perform the service rather than when the accountant prepares and presents the financial statements.

A report would always be required, and the proposed standard would maintain the current requirement to modify the report when the accountant's independence is impaired.

The new, proposed preparation standard would govern engagements in which the accountant prepares financial statements but does not perform a compilation, review, or audit. The standard would require the accountant to place a legend on each page stating that no assurance is being provided.

The proposed association standard applies when the accountant allows use of his

or her name in a report, document, or communication that contains financial statements on which the accountant has not issued an audit, review, or compilation report. In these cases, the financial statements would be required to be marked to indicate that no CPA provides any assurance on the financial statements, or a disclaimer of opinion would be required.

ARSC proposed the association standard because AU Section 504 (which was withdrawn as part of the clarity project) addressed unaudited financial statements. ARSC and the AICPA Auditing Standards Board decided the guidance should be moved from the auditing literature to the Statements on Standards for Accounting and Review Services.

■ The Private Company Council (PCC) approved its first GAAP exceptions for private companies and has forwarded them to FASB for final endorsement.

If FASB endorses the exceptions, they will be written into GAAP. These would be the first GAAP exceptions approved by the PCC, which was formed last year by FASB's parent body, the Financial Accounting Foundation, in part to create exceptions and modifications to GAAP for private companies.

The exceptions approved by the PCC would:

- Allow private companies to choose a simplified hedge accounting approach to their financial reporting when they enter into interest rate swaps to economically convert their variable-rate interest payments to fixed-rate interest payments.
- Give private companies the ability to amortize goodwill acquired in a business combination.

The exceptions would take effect for fiscal years beginning after Dec. 15, 2014, and early adoption would be permitted.

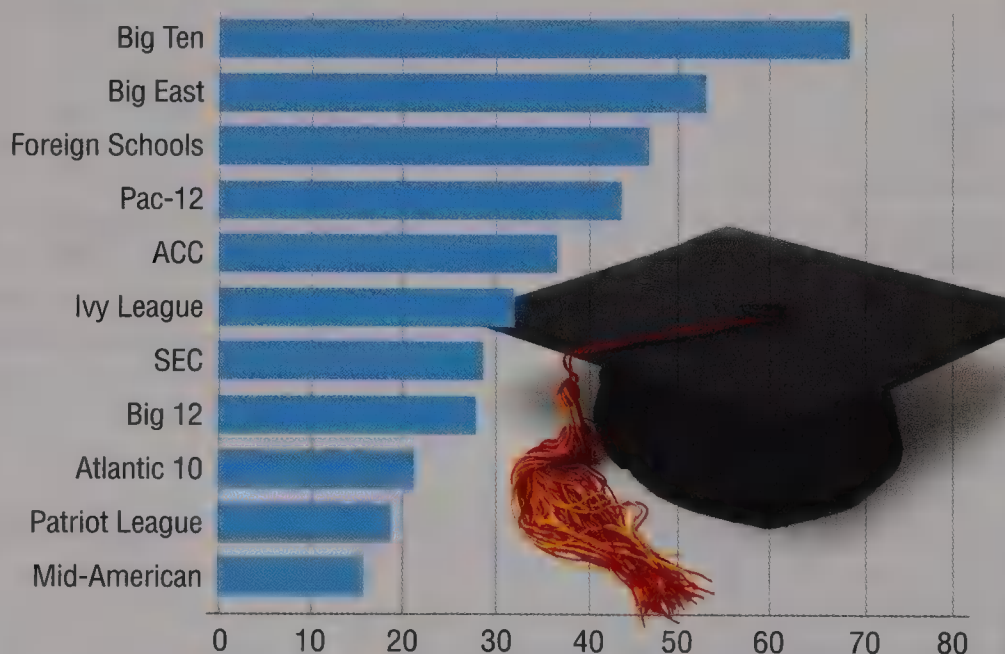
■ A FASB advisory committee asked stakeholders what they thought the board's standard-setting priorities should be. Respondents said they wanted simplicity and better information.

The top three reasons improvements are needed to financial reporting standards,

Big Ten Leads in CFOs

More current CFOs in the *Fortune* 500 and Standard & Poor's 500 completed their undergraduate education at schools in the Big Ten than any other conference, according to the *Crist|Kolder Associates Volatility Report* for 2013. The report gathered educational backgrounds of 602 sitting CFOs as of Aug. 1, 2013, before a conference realignment that affected several affiliations—including the move of Notre Dame (11 CFOs) from the Big East to the ACC—took effect.

Number of CFOs



Source: Crist|Kolder Associates Volatility Report 2013, tinyurl.com/lvsgm77.

according to 105 respondents participating in a Financial Accounting Standards Advisory Council (FASAC) survey, are:

- Simplification is needed.
- Better information is needed.
- Current information does not provide decision-useful information to investors and other users of financial reports.

The disclosure framework project, whose aim is to streamline disclosures in the footnotes to financial statements and make them more effective, was ranked as the most important project on FASB's agenda for the next three to five years.

Full results of the survey are available at tinyurl.com/mjwolcm.

FASAC is FASB's primary advisory group.

The survey asked respondents to rank the importance of various early-stage projects (see chart on the following page). The project listing excluded active agenda projects that FASB expects to complete by the third quarter of 2013 or expected to issue an exposure draft in by the second quarter of 2013.

■ Going-concern assertions are appropriately made by management, the AICPA Financial Reporting Executive Committee (FinREC) and the Center for Audit Quality (CAQ) said in comment letters supporting a FASB proposal.

The proposal, *Presentation of Financial Statements (Topic 205), Disclosure of Uncertainties About an Entity's Going Concern Presumption*, is available at tinyurl.com/k5ukatu.

FinREC and the CAQ, which is affiliated with the AICPA, both commended FASB for its work developing a going-concern model that requires preparers to perform a going-concern assessment and, where required, provide footnote disclosures about going-concern uncertainties in each reporting period.

FASB is undertaking the project because U.S. GAAP does not explicitly define financial statement preparers' responsibilities with respect to disclosing conditions that may give rise to substantial doubt about an entity's ability to continue as a going concern.

Financial statements currently are prepared under the presumption that an entity

HIGHLIGHTS

(Continued from page 11)

The proposal, available at tinyurl.com/nm6ghaq, would classify "Type A" leases as those during which a more than insignificant portion of the value of the leased item is consumed. These would include most vehicle and equipment leases. Type A lessees would recognize a lease as a nonfinancial asset measured at cost, less amortization. This would result in a total lease expense that generally would decrease over the lease term.

During Type B leases, a more than insignificant portion of the value of the leased item is not consumed. In Type B leases, which would include most real estate leases, lessees would report a straight-line lease expense.

The AICPA Financial Reporting Executive Committee (FinREC) suggested that the boards should not use the "more than insignificant" concept to differentiate between Type A and Type B leases. FinREC, which is authorized to make public statements on behalf of the AICPA on financial reporting matters, supported the proposal's objectives and its dual-model approach for lessee and lessor accounting. But FinREC recommended that leases consistent with in-substance finance purchases be accounted for as Type A leases, and that other leases be accounted for as Type B.

FASB's own Investor Advisory Committee (IAC) also opposes the proposal.

The boards have expressed a desire to have a final standard in place by 2014, although implementation is not expected to occur earlier than fiscal years beginning Jan. 1, 2017.

will be able to realize its assets and meet its obligations in the ordinary course of business. When liquidation is imminent, the organization starts applying the liquidation basis of accounting in its financial statements.

Currently, auditors are required under U.S. auditing standards to assess whether there is substantial doubt about an entity's ability to continue as a going concern.

FASB asked stakeholders to evaluate whether possible bias on the part of management would cause its going-concern evaluation to be of little use for investors. Both FinREC and the CAQ said management bias has the potential to affect other aspects of financial reporting, too, so an exception should not be made with respect to going concern.

"Management should be making a going-concern assessment," Aaron Anderson, CPA, a FinREC member and chairman of its going-concern task force, said in a telephone interview. "It should not be just left in the hands of the auditor."

In addition, FinREC welcomed the clarifications in the proposal around the definition of "going concern," clarification about the time horizon over which

an entity should be evaluated, and clarification about the information used in that evaluation.

The full comment letters are available at tinyurl.com/qztxxon (FinREC) and tinyurl.com/oc99p63 (CAQ).

GOVERNMENT

■ Former U.S. Comptroller General David Walker is closing a chapter in his campaign against the rising tide of government debt, but he is urging his fellow CPAs to help fight against what he calls fiscal irresponsibility by elected leaders.

Walker released the final report of his Comeback America Initiative, once again highlighting problems facing the finances of the federal government, states, and cities. The report is available at tinyurl.com/p4czdoo. Walker said he is closing his not-for-profit initiative to keep a long-standing commitment to his wife, Mary, to spend more time with his family.

But he is not retiring, he said, and as long as he is healthy, he won't quit his fight



Walker

for government fiscal responsibility. He called on CPAs to join him.

"People need to keep in mind that the 'P' in 'CPA' stands for 'Public,'" Walker said during an interview with the *JofA*. "We have a public trust. We have to act in the public interest. We need make sure we are taking steps that improve accounting and reporting for governments. We've come a long way, but we've got a ways to go."

The final Comeback America report presents a calculation that combines the federal government's explicit liabilities, commitments, contingencies, and unfunded Social Security and Medicare promises.

In present-value dollars, the total in 2012 of these "off-balance-sheet obligations" was \$69.7 trillion, or \$221,400 per person. The total has more than tripled since 2000, when it was \$20.4 trillion, according to Walker's analysis. Walker said most states and many cities also have financial problems that mirror the federal government's, with unfunded obligations for retirement and retiree health care, and

outdated tax systems.

HUMAN RESOURCES

■ Starting salaries for finance professionals in the United States continue to show signs of growth, and hiring demand for recent college graduates is on the rise. Meanwhile, the CPA designation is employers' most sought-after credential, according to a new guide on salaries.

Average starting salaries for jobs in corporate accounting are expected to rise between 2.9% and 4.5%, depending on the specific role and the size of the company, according to the Robert Half 2014 Salary Guide for accounting and finance.

The guide is available at tinyurl.com/lkzxfwq.

MANAGEMENT ACCOUNTING

■ A rule proposed by the SEC would require U.S. public companies to disclose the ratio between what companies pay their CEOs and their median employee.

SEC commissioners voted 3–2 to pro-

pose the rule, which was mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, P.L. 111-203.

If the rule is approved, companies would be required to disclose:

- The median of the total annual compensation of all their employees except the CEO.
- The annual total compensation of the CEO.
- The ratio of the two amounts.

The proposal, available at tinyurl.com/ou47lmc, was drafted to provide companies with flexibility in complying with the requirement while fulfilling the Dodd-Frank requirement, SEC Chairman Mary Jo White said.

PUBLIC ACCOUNTING

■ Many CPA services are excluded from the activities that would require registration as a municipal adviser under new rules approved by the SEC.

Under the regulations, which were scaled back from a previous proposal, CPAs would not be required to register as municipal advisers if they are providing audit or attest services, preparing financial statements, or issuing letters for underwriters, according to a specific exemption given by the SEC.

But CPAs and others who provide certain other advice to municipalities—including tax advice on municipal securities offerings—will be required to register with the SEC as municipal advisers.

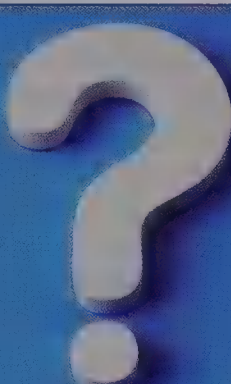
The SEC voted unanimously to adopt rules to establish a permanent registration of municipal advisers, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, P.L. 111-203. The rules are available at tinyurl.com/k5ksxey.

State and local governments that issue municipal bonds often rely on the expertise of municipal advisers to help them decide how and when to issue the securities and how to invest proceeds from the sales. The rules require municipal advisers to register with the SEC if they provide advice on the issuance of municipal securities, certain investment strategies, or municipal derivatives.

The new rules take effect 60 days after

What Should FASB Prioritize?

Respondents to a Financial Accounting Standards Advisory Council (FASAC) survey were given 100 points to "spend" on projects they believed should be on FASB's agenda for the next three to five years. They were asked to allocate their points to reflect how deficient U.S. GAAP is and how urgent it is that FASB address the topic. Eighty-three respondents completed the exercise. Here are the top 10 results:



Project	Points
1. Disclosure Framework	1,282
2. Accounting for Financial Instruments: Hedging	1,064
3. Conceptual Framework	711
4. Financial Instruments With Characteristics of Equity	590
5. (tie) Pensions	538
5. (tie) Financial Statement Presentation	538
7. Accounting for Financial Instruments: Liquidity and Interest Rate Disclosures	393
8. Intangible Assets (recognition, initial measurement, and amortization)	329
9. Not-for-Profit Financial Reporting: Financial Statements	296
10. Income Taxes	263

Source: Responses to the FASAC Survey, tinyurl.com/mjwolcm.

they are published in the *Federal Register*.

The AICPA generally supported the investor protections in the proposed rules but was concerned that the broad definition of "municipal advisor" in the proposed rules would apply to accountants performing customary accounting services who should not have been subjected to the required registration.

AICPA President and CEO Barry Melancon, CPA, CGMA, commended the SEC for its flexibility on the issue. He also acknowledged the support of members of Congress who introduced legislation that would have exempted accountants from the municipal adviser definition.

"Accountants providing audit and attestation services are already subject to layers of regulation that are intended to protect investors," Melancon said in a statement. "We are pleased that the SEC expanded the accountant exemption to include audit and attestation engagements, preparation of financial statements, and the issuance of letters for underwriters."

FYI

■ The SEC's Office of the Chief Accountant (OCA) is accepting applications for Professional Accounting Fellow (PAF) positions.

The PAF program provides fellows with opportunities for public service to investors, personal development, and career advancement.

Fellows will participate in the study and development of rule proposals under the federal securities laws; liaise with accounting, auditing, and other professional standard-setting bodies; and consult with registrants on reporting matters. OCA plans to select the following:

- Candidates with significant experience in the application of U.S. GAAP (areas of specialty may include, but are not limited to, accounting topics such as revenue, consolidation, debt and equity, derivatives, and financial instruments);
- A candidate with significant experience in performing and reviewing valuations for financial reporting

purposes (areas of specialty may include, but are not limited to, business enterprise valuations, valuations of financial instruments and other complex securities, along with intangible assets);

- Candidates with significant experience analyzing and implementing auditing, independence, and/or quality-control standards and policies (areas of specialty may include, but are not limited to, the development and implementation of audit policy and methodology and the performance of audits of broker-dealers).

Applications are due Jan. 10, 2014.

Information regarding the required application submission is available at tinyurl.com/n6mmj4o. For more information, call Ryan Evans at 202-551-5316 or Chris Rogers at 202-551-4334.

DRAFTS OUTSTANDING

■ IFAC

The Role and Expectations of a CFO: A Global Debate on Preparing Accountants for Finance Leadership. Comment deadline: Feb. 14. Discussion paper available at tinyurl.com/ndcmldg.

■ ARSC (AICPA)

Proposed Statements on Standards for Accounting and Review Services: *Preparation of Financial Statements*; *Compilation Engagements*; and *Association With Financial Statements*. Comment deadline: May 2. ED available at tinyurl.com/o794byc.

CORRECTION

■ In the November 2013 issue, in the article, "Before You Sign: Natural Gas Lease Tax Issues," the first paragraph under the heading "Land Lease Payments" on page 45 should have read: "Amounts received for upfront land leases that energy companies pay to permit drilling on the land are rental income for federal income tax purposes, which means the payments will be ordinary income. However, because the land is nondepreciable property, under Regs. Secs. 1.469-2T(f)(3) and -2(f)(10), the income is treated as portfolio income rather than passive income." ♦



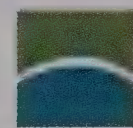
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SPOTLIGHT

Billing for Defense (and Payment)

by Deborah K. Rood, CPA

Many CPAs consider billing an unpleasant task, and that distaste leads to procrastination and lax practices. However, poor billing and collection practices may adversely affect the defense of a professional liability claim.

Kerry Callahan, a principal and chairman of the litigation department of Connecticut-based Updike, Kelly & Spellacy PC, told of a CPA engaged by a wealthy client to temporarily serve as a “financial manager.” Because the CPA had lax billing practices, the client continued to receive invoices for these services after they had ended. Over the next several years, the client lost millions and sued the CPA for providing poor investment advice. The case was settled because of the difficulty of defending the billing discrepancies.

WHERE TO BEGIN

Good billing practices start before services commence. Consider the following:

Client and engagement acceptance and continuance. During the client acceptance process, CPAs can identify slow payers or nonpayers by contacting the predecessor CPA. Even though the CPA may not disclose this confidential information, the successor should gauge the predecessor’s reaction.

In addition, the CPA can check the prospect’s credit history. Unsolicited prospects seeking assistance with delinquent tax filings should be approached with caution. Prospects with a history of regularly changing CPA firms also should be avoided.

Long-standing clients may experience financial hardships leading to slow payment. CPAs should require regularly scheduled payments. To avoid fee disputes, practitioners should consider making the continuation of services contingent upon obtaining a signed promissory note for outstanding fees. Promissory notes should be drafted by legal counsel to ensure enforceability. If necessary, services should be suspended. If the problem persists, the CPA should terminate the engagement before outstanding receivables become unmanageable.

Engagement letters. The engagement letter should clearly communicate billing and collection terms, including the consequences of nonpayment, such as assessment of interest and fees related to any collection action. It should permit withdrawal from the engagement for nonpayment. Engagement letter terms

should be reviewed with the client to ensure mutual understanding.

Retainers. The risk of nonpayment is heightened with new clients, slow payers, or clients with delinquent tax filing obligations. In such cases, CPAs should obtain an upfront retainer, and then bill and collect monthly. Practitioners should consider obtaining a retainer for services related to a prospective or expected transaction or outcome, such as merger and acquisition services, forecasts, projections, valuations, and forensic or litigation services. Obtaining a retainer and maintaining a positive retainer balance help minimize the risk of nonpayment.

DURING THE ENGAGEMENT

It is not possible to identify and address all potential contingencies before an engagement begins. If a change in services is required during the engagement, a CPA should obtain the client’s written approval before rendering services.

Gregg Weinberg, a shareholder and leader of the professional liability group of the Texas-based law firm Roberts Markel Weinberg PC, said the engagement letter can be a key to winning a case that involves scope and billing disputes. A CPA can get into trouble if he or she acts outside of the scope of the engagement letter and bills for it. Instead, Weinberg said the engagement letter should be like the Constitution—a living, breathing document. If something is outside the scope of the engagement, it needs to be documented, even in an email, and the terms of the original engagement letter should apply.

IT’S TIME TO BILL

When. Generally, billing should be issued concurrently with the engagement’s completion. For example, invoices for payroll and bookkeeping services should be issued monthly, and those for tax return compliance should be sent with the tax return. For larger projects, such as audits and consulting services, bills should be sent monthly. This procedure provides the firm with an opportunity to suspend services if collections lag.

Who. The engagement team should be held accountable for generating accurate and timely bills. The team members will know what services were provided, what, if any, changes in scope occurred, and how the client will react to the invoice.

What. The billing narrative should clearly define services performed, or, alternatively, the engagement letter may be attached to the invoice. CPAs should avoid indiscriminate use of terms defined in professional standards, such as “audit,” “review,” and “examine.” The scope of services defined in the engagement letter and workpapers should be consistent with the invoice. When the descriptions in invoices, the engagement letter, and workpapers align, the collectibility of outstanding fees and defense of a professional liability claim are strengthened. If billing descriptions are inaccurate or overstate services provided, CPAs may be held accountable for services they did not perform.

John Elzufon, managing director of the Delaware-based law firm

Elzufon Austin Tarlov & Mondell PA, said CPAs should not view a bill solely as an invoice for services performed. Instead, it is an additional way to professionally communicate with a client. "Like any form of communication, when it is thorough and accurate, it's useful," he said. "When it is incomplete, slipshod, and full of errors, it's not."

Elzufon added, "An inaccurate bill raises in your client's mind the quality of the services performed. Like any other form of communication, it also needs to be timely and consistent."

How. For some clients, a phone call to inform them a bill is coming is appropriate, especially if the client previously did not pay timely or objected to additional billings. This gives the CPA an opportunity to discuss issues early and prevent future collection problems.

AFTER THE BILL IS MAILED

Aggressive collection efforts, including hiring a collection agency or suing a client for outstanding fees, can result in a countersuit from the client that alleges negligence. CPAs should be proactive and prevent receivables from becoming past due. They should consider establishing standardized administrative processes to escalate delinquent accounts for further action by an executive committee within the firm.

IN THE END

Accurate billing records can prove valuable in defending a malpractice claim—such as indicating that a conversation between the CPA and the client occurred. Elzufon said that a bill is a contemporaneous document and billing software can prove valuable since nobody can remember a conversation that occurred five years ago.

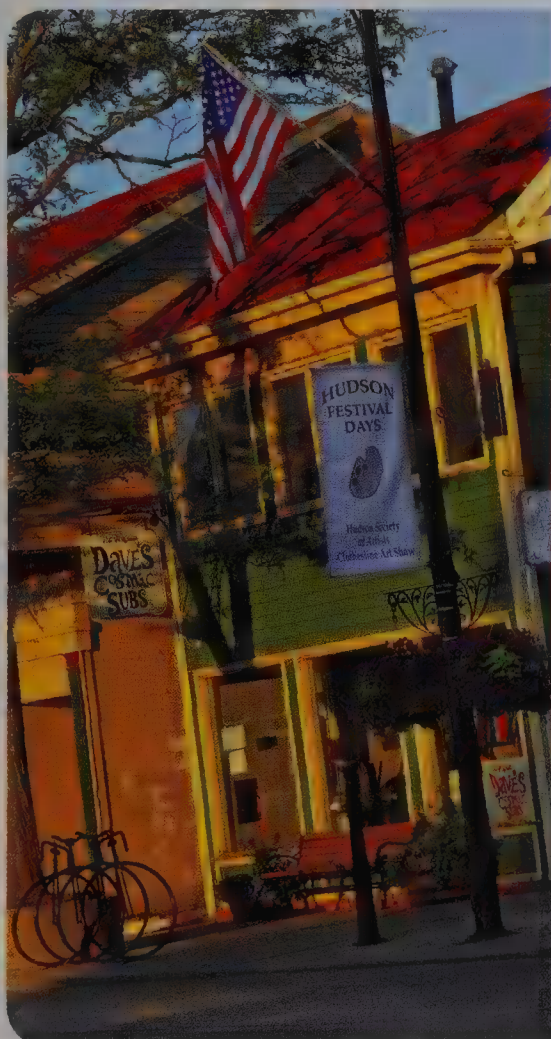
Such documentation will result in better cash management, avoiding the time and expense of suing for unpaid fees and risking a countersuit.

Deborah K. Rood (deborah.rood@cna.com) is a risk control consulting director at CNA.

Continental Casualty Co., one of the CNA insurance companies, is the underwriter of the AICPA Professional Liability Insurance Program. Aon Insurance Services, the National Program Administrator for the AICPA Professional Liability Program, is available at 800-221-3023 or visit cpai.com.

This article provides information, rather than advice or opinion. It is accurate to the best of the author's knowledge as of the article date. This article should not be viewed as a substitute for recommendations of a retained professional. Such consultation is recommended in applying this material in any particular factual situations.

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A New Financial Reporting Framework for Small Business Has Arrived

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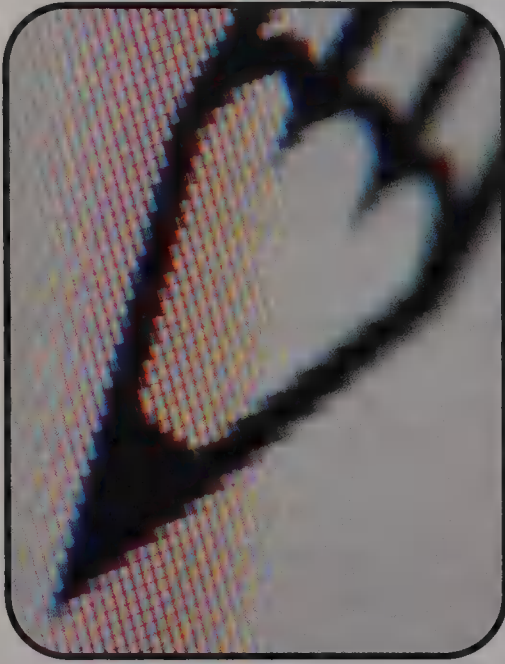


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Honing Your Hiring

It takes some detective work to hire the right new employee. Management needs to piece together clues about the applicant's personality and work history. It takes time to determine whether a candidate has the character and credentials to fit the company's needs. Here are a few steps to help you land the right candidates.

are most like. However, the best predictor of success is a candidate's past behavior and results, not his or her interviewing prowess.

"What was the most difficult culture you've had to work in, and how did you deal with it?" or "Who have been your favorite and least favorite bosses and co-workers?" The answers should provide clues about the candidate's character and how he or she likes to work.

✓ **Put equal weight on assessing candidates' fit for your culture as on evaluating their qualifications.** To determine fit, you need to assess the organization's culture—or, if you want to change it, the desired culture. Is the company's work done in a collaborative or individualistic manner? Are decisions made by consensus or by command and control? Consider communication styles, meetings, organizational structure, performance management, and the hours of work to determine whether a candidate will fit the company's culture.

✓ **Define the specific behavioral requirements by categories of positions.** Identify the personalities and work styles that fit the company's culture or desired culture. This exercise should result in a list of adjectives and behaviors of successful people.

✓ **Screen for the right job skills.** Many companies screen candidates based on outdated, generic, or "safe" job descriptions and conduct predictable interviews. Thousands of books have been written relating to interviewing. Candidates are prepared for standard interview questions about strengths and weaknesses or what animal they

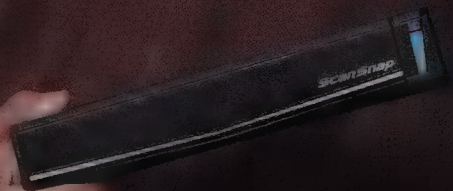
✓ **Determine in advance what success looks like in the open position after six months, one year, and three years.** Find out how candidates achieved similar success at other companies. One success factor for a CFO position might be to determine within 12 months whether to shut down two underperforming business units. Have applicants describe how they have made such decisions at other companies. Make sure that the candidate has done what he or she says, and find out what the results were in that project. Most applicants aren't used to being grilled like this, so your sleuthing is apt to discover misleading statements and role exaggeration at many turns.

✓ **For finalists, conduct 360-degree behavioral interviews to develop a broader picture of the applicant in different settings.** A 360-degree behavioral interview would include the applicant's prospective boss, peers, and direct reports. Each person should present work scenarios related to his or her area and ask candidates to describe how they have handled similar situations in the past. They should ask things such as:

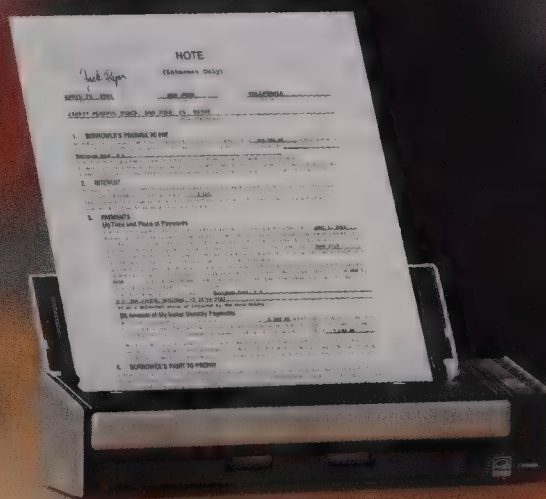
✓ **Verify credentials.** Depending on the position, a bad hire can cost a company from \$25,000 to \$300,000, according to a National Business Research Institute study. Costs include reduced sales, poor morale, turnover, poorer client relations, training, lost productivity, and HR and interviewing costs. Despite the potential costs of a bad hire, many companies skimp on in-depth background checks and assessments for myriad reasons, including cost, time, and skepticism. Several studies have also found that large percentages of job applications or résumés contain false or misleading information. Slow down and spend \$100 or so to make sure a candidate has been truthful.

Editor's note: This checklist is adapted from the article, "How to Hire the Right Employee," CPA Insider, Sept. 16, 2013, available at tinyurl.com/nujauhn.

—By **Doug Blizzard** (doug.blizzard@capital.org), vice president of membership at CAI Inc.



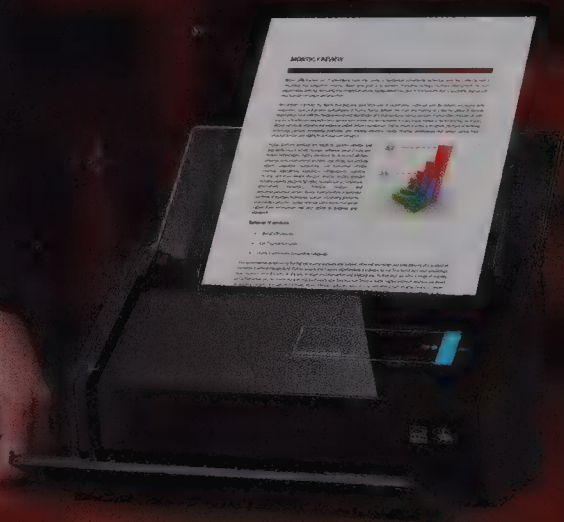
I'm mobile



I'm flexible

ScanSnap

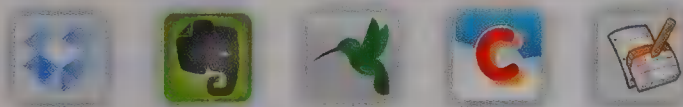
I'm wireless



I'm versatile



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How to Be a Better Delegator

Being able to delegate well allows effective leaders to free themselves to do high-value tasks and to improve their own performance. Here are seven tips on how to delegate more effectively.

Consider the benefits. Delegation isn't just about freeing yourself from tasks that are beneath your pay grade—it is also about making those who work for you happier. The flip side of delegation is empowerment. Letting people get on with their jobs and giving them control is a huge motivator and will result in a boost in their discretionary effort. By giving them new tasks that stretch them, you build up their skills and advance their careers. This makes you the kind of manager any ambitious person wants to work for.

Set the scope. Delegate as much as you can. Senior managers should keep only three main areas. The first is big picture stuff, such as strategy; the second is important tasks where you can make a real difference; the third is relationships—for this reason many senior people ensure they're involved in recruiting. Pretty much everything else can be done by someone else.

Know what not to delegate. Don't pass on tasks involving highly confidential information unless the person to whom

you are delegating them has a similar level of clearance. For various reasons, you shouldn't delegate jobs simply because you don't like doing them; this can be very demoralizing. Similarly, don't hang on to low-grade jobs just because you really enjoy them, although it doesn't hurt to get your hands dirty occasionally.

Learn to let go. Many managers find delegating excruciatingly difficult. The biggest single reason for this: control freakery. A lot of people believe that if you want a job done well, you have to do it yourself. Those people are chronic micromanagers. Micromanagement demotivates those below you. If you struggle with this, start small. Delegate a little. Then, if your employees do a good job, delegate a little more. This should result in a virtuous circle. And try thinking about the alternative: If you hang on to every task that you do now, how will you ever progress? Think, too, about low-value tasks you have already dropped—and how little you miss them.

Set a detailed brief. Some managers are poor delegators because they just hand over tasks and assume the work will get done. Properly selecting and briefing those to whom you delegate is an investment that will pay back many times over. Agree on how the task will be done, discuss a time frame, and decide how progress will be measured. The next time you do it, it'll be easier, and



the time after that easier still. What you're doing is creating a template for delegation and building your reputation as someone from whom others are happy to take delegation.

Provide the right tools. Remember, too, that those to whom you delegate need to be given the tools and resources to accomplish their tasks. If you delegate sorting out the team's travel itinerary to a personal assistant, he or she will need credit cards, access to contacts at travel management companies, and so on. You should monitor what staff members are doing, without meddling, and listen to suggestions. You also need to ensure that people know your door is open if they have problems. It is far bet-

ter for staff to ask minor questions at the beginning that prevent a disaster two days from the completion date.

Offer feedback. If those to whom you delegate tasks do them well, ensure that you give them positive feedback and that they get the credit elsewhere in the organization. This requires a bit of conscious effort. It's very easy to slip into giving feedback only when jobs are done badly. And people are likely to praise you rather than your team. But positive feedback is hugely motivating, and telling others that your team did the work reflects very well on you as a leader.

The original version of this article, "Seven Ways to Improve Your Delegating

Skills," by Rhymer Rigby, is available at tinyurl.com/njvtttdg.

—Jack Hagel, editorial director
CGMA Magazine

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MORE DIRECTORS THINK A FELLOW BOARD MEMBER SHOULD GO

More than one-third of corporate directors say their own boards have underperforming members, according to PwC US's 2013 Annual Corporate Directors Survey.

Thirty-five percent of the 934 public company directors surveyed said someone on their board should be replaced, up from 31% in 2012.

Directors who are new to boards were more likely to perceive deficiencies in their fellow board members' performance. More than half of directors who have served for less than a year believe a fellow board member should be replaced, but less than one-fourth of those who have served more than 10 years would like a board member replaced.

The full article, "Corporate Directors Say New Regulations Aren't Worth the Costs," by Ken Tysiac, is available at tinyurl.com/p26zmd2.

RIISING TRANSFER-PRICING SCRUTINY DIALS UP RISK

Multinational companies are increasingly concerned about transfer-pricing matters, research by EY suggests. Growing scrutiny of transfer-pricing practices, particularly in emerging economies such as Brazil, Russia, India, China, and South Africa, and upcoming changes to existing transfer-pricing frameworks drive the concerns.

Two-thirds of respondents, which included more than 600 senior executives at parent companies in 26 countries,

identified risk management as their top transfer-pricing priority. That's up from 50% in 2010.

Respondents reported that, in the past year, examinations by revenue authorities have expanded in scope and complexity, and the number of cases where adjustments resulted in penalties increased to 24%, from 19% in 2010 and 15% in 2007. Documentation requirements became stricter, and the number of unresolved reviews and audits were up.

The full article, "Rising Transfer-Pricing Scrutiny Dials Up Risk," by Sabine Vollmer, is available at tinyurl.com/nfs2r5k.

COMPANIES GIVING "STARS" BIGGER RAISES

Top performers at many U.S. companies are receiving higher raises than their average and low-performing counterparts, but an appetite for even greater rewards for the best employees remains.

Exempt workers who received the highest performance ratings were given an average salary increase of 4.6% in 2013, according to a survey of 910 U.S. companies by professional services company Towers Watson.

Exempt employees with average performance ratings received an average raise of 2.6%, and workers with below-average performance ratings received an average raise of 1.3%.

The full article, "Retention-Focused US Companies Giving 'Stars' Bigger Raises," by Ken Tysiac, is available at tinyurl.com/lajy7q4.



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A photograph of a climbing wall with various colorful holds (green, red, orange, black) and a rope running vertically on the left side. The wall has a textured, light-colored surface.

How to Conduct a Risk Workshop

The steps Humana takes to align
business units with its ERM strategies

by Neil Amato

Humana is a company of 50,000 people, so assessing and addressing all the risks that each segment of the company encounters is no easy feat.

For years, Humana, a multibillion-dollar player in managed health care and health insurance, had a top-down approach to risk. But a few years ago, the company decided it wanted to manage risk from the bottom up as well. It needed more voices to make sure its risk strategies weren't solely the view of those in the executive suite.

"As we were doing audit engagements and having conversations with the businesses, we realized the businesses had a very valuable perspective that isn't necessarily transparent up to the top of the organization," said Jennifer McCallister, a consulting leader in Humana's internal audit consulting group.

So the internal audit department, which facilitates Humana's enterprise risk management (ERM) program in concert with the executive-populated Enterprise Risk Management Committee, decided to hold risk workshops with the business units. Leadership across the company is accountable and responsible for the risk management process, and the workshops are just one of the tools available. The workshop is one part of a five-step process designed to tease out risks and give the business unit's members a better understanding of exactly what risk is, how it can hamper business-unit objectives, and how it relates to the company's ERM strategies (see the sidebar "Three Top Benefits of Conducting Risk Workshops").

Humana has been conducting the workshops since 2009, with slight tweaks along the way. Hundreds of workshops have been done by the internal audit department. This article breaks down Humana's five-step process.

PHASE 1: LEADER INTRODUCTION AND BUY-IN

This phase is initiated, in general, by a call from a specific business area. Maybe there's

Risk Culture Measures

In the survey before any risk workshop, Humana asks its employees to respond to four statements relating to risk culture. No matter the department, all employees are asked to rate the same four statements on a Likert scale (strongly agree, agree, neutral, disagree, strongly disagree), along with the option to answer "I don't know."

The four statements are:

1. I feel comfortable with my ability to identify and assess risks that may materially impact my business segment.
2. Management has provided a framework (common language and methodology) with which I can evaluate risks and controls in my part of the business.
3. I periodically identify key risks in my area of responsibility and communicate them to my leader.
4. The leadership team I am a part of fosters an open and collaborative discussion around risk.

"This helps us to trend risk culture across the organization," said Jennifer McCallister, a consulting leader in Humana's internal audit consulting group. "Are there pockets of the company that don't like to talk about risk or are not encouraged to talk about risk?"

a new vice president who wants to gauge the sentiment about risk in the department.

McCallister said support and tone at the top are critical to the effectiveness of the workshop and that, in general, the messages about the workshop come from the department heads, not the internal audit department. The reason is simple: Employees are far more likely to listen to instructions from their leader than from someone in another department, likely

someone they've never met.

This phase requires gaining support from leadership to use the workshop approach and tools to identify and assess risks. "We're engaging folks that maybe aren't traditionally approached by internal audit," McCallister said. "It's not us saying, 'We're coming in and we're doing this.' It's us offering to help provide the business with tools and techniques to identify and assess risks, so it's essential that we have buy-in from the top."

PHASE 2: LEADER RISK DISCUSSION

The VP is briefed on the company's approach to ERM and given an overview of the workshop process. The leader also gets a chance to provide perspective on department strategy and objectives and to point out risks. "We ask them, 'Do you have any key risks that are top of mind? Is there anything that's giving you heartburn?'" McCallister said.

This phase was one of the tweaks to the workshop process about six months in. Previously, the VP took part in the risk discussion (Phase 4) at the same time as the employees. This was not always ideal, as the internal audit team noticed employees tended to be more candid without their leader in the room.

"We wanted to foster an environment where employees could openly share their perspectives on risk, so we decided to get the leader's perspective first and give the option to participate in the workshop," McCallister said. "Most times, the leader is good with having the risk discussion first.

Three Top Benefits of Conducting Risk Workshops

The process got people more conversant about risk. Jennifer McCallister, consulting leader in Humana's internal audit consulting group, didn't want to diminish the value of the final report on each business unit's risk workshop, but she believes the workshop itself is vital. "Most of the value that the participants are identifying is through having the conversations, getting people in a room, and understanding different perspectives, so that they can come to consensus on where a certain risk falls in relation to their business area but also in relation to the enterprise," McCallister said.

The process led to the creation of risk ambassadors. McCallister said that internal audit's phone rings more now because workshop participants are sharing their experience with others. The ambassadors are also used as a backup if a business unit's leader is skeptical about the value of the workshop process. "If they have concerns, I encourage them to contact someone who has already done a workshop," she said. "Once they go through the workshop, they have a better understanding of risk and what its impact is."

The process can be duplicated for recently acquired entities. Humana has made numerous acquisitions over the years and is likely to continue to look for growth opportunities. The workshop process can help a soon-to-be subsidiary become more easily integrated with Humana. The process can help both sides understand the other's risk environment and give the subsidiary a chance to leverage some of Humana's risk-assessment tools.

This phase helps us to understand risk from that leader's perspective and helps to provide context for the workshop."

PHASE 3: EDUCATION AND SURVEY

Employees receive from their VP a document that gives an overview of Humana's ERM strategy and expectations for the workshop itself, as well as definitions of a few key terms, such as "mitigation" and "controls."

In the same email, they receive a link to an online survey. They have about two weeks to complete the survey, which takes 10–15 minutes. The survey starts with the same four statements for everyone (see the sidebar "Risk Culture Measures").

Then, the questions become more open-ended. Employees are asked about the department's top financial, strategic, compliance, and operational risks. The survey can be tailored to ask specific questions about the department.

EXECUTIVE SUMMARY

■ **Humana had top-down risk management practices in place, but it wanted a bottom-up approach as well.** The company thought it could spread the word about risk through a series of risk workshops.

■ **The first phase of the process is to gain buy-in from executives.** The messages about

the reasons for the workshops and instructions on how to start the process are sent by department leaders, not internal audit.

■ **Phases 2 and 3 involve educating both the department heads and the managers who will take part.** A survey is used to gauge the department's risk culture.

■ **Phase 4 is the workshop itself.** This involves a series of conversations with the survey participants, leading to the creation of department-specific risk statements, as well as ranking and prioritizing the department's risks.

■ **The final phase is a report that sums up the department's top risks.** The benefits of the

workshop go beyond that one document. The process has made many in the company more conversant about risk management.

Neil Amato is a JofA senior editor. To comment on this article or to suggest an idea for another article, contact him at namato@aicpa.org or 919-402-2187.

The internal audit team then analyzes the survey results. They group open-ended comments into categories, a process McCallister calls “affinitizing,” and then try to translate the voice of the survey respondents into risk statements.

PHASE 4: WORKSHOP

The workshop itself takes, on average, half a day, but it can take longer depending on the scope and number of people attending. During this phase, internal audit continues the conversation with the members

going, but it’s not quite right.’ We make sure everyone’s comfortable with the wording of each risk statement.”

Then the workshop participants are asked if any risks have been left out. “We use a risk framework as a brainstorming tool,” McCallister said. “We ask participants to review the framework as a way to make sure they’ve considered all types of risks.”

Once all the risks have been compiled, they are ranked and prioritized. Humana uses a grid similar to other companies’ heat maps, but it has one key difference. The

“We ask participants to review the framework as a way to make sure they’ve considered all types of risks.”—Jennifer McCallister of Humana’s internal audit consulting group

of the business area, this time with old-fashioned, in-person conversation and not an email or online survey.

First is yet another introduction to Humana’s ERM approach and how it ties in with that business area. Then internal audit goes over the survey results, both for the risk culture statement responses and the open-ended survey questions. If the answers show any pressing concerns, internal audit facilitates conversations to address those during this phase.

Workshop participants then discuss with facilitators the business unit’s primary objectives and goals. Once these are identified, workshop participants are prompted to consider the objectives and goals as they progress through the workshop. Then risk statements that were formulated by internal audit based on the survey results are shared with the group. The statements are discussed in detail and altered as needed based on the advice of the workshop participants. The process relies on the conversations about the best way to phrase a risk statement so that it makes sense and is relevant to the department, not just to the person who mentioned the risk in the survey.

“We will ask, ‘What does this mean to you?’” McCallister said. “Sometimes, we hear, ‘I have no idea.’ Or ‘I see where you’re

X-axis is for “impact”—the farther out, the greater the potential impact. But the Y-axis doesn’t measure the likelihood that the risk will occur. Instead, its measure is “how well managed” the risk is—the farther out, the worse the risk is managed.

Employees rate impact on a three-point scale: high, medium, and low. They have three choices about how a risk is being managed: well, somewhat, or not at all.

Those risks are then plotted on a risk map, and specifically designed voting software orders the risks by impact and level of management. Then they are prioritized by employee input. Risk 1 is compared to Risk 2, and employees are asked, “Which one is riskier?” The riskier of the two is then compared to Risk 3 and so on.

It’s possible that the risks in the top right of the risk map (those that have the highest impact and the lowest level of management) are not the top priority. McCallister said this is because the mitigation of a less serious risk can lead to the mitigation of the so-called top risks. “Think about the concept of low-hanging fruit,” she said. “If the optimization of a less severe risk requires fewer resources and has a positive impact on one or more of the higher-rated risks, the business will often prioritize those efforts over a risk that requires more resources.”

PHASE 5: FINAL DELIVERABLE

The goal is to have a final report two weeks after the workshop. But that report’s first draft is in the hands of the business unit leader two days after the workshop.

“The report is used by management to circle back and look at their strategy,” McCallister said. “They want to know if there are risks in this report that are not a part of their strategy. It can also be used by internal audit to see if there’s some risk we want to check on.”

Internal audit also compares the results of each workshop with those of others and applies the results to the company’s overall risk framework. The data can begin to show whether the same types of risks keep popping up across the company.

The process has resulted in two specific risks—ones that Humana declined to disclose, but that came up regularly in workshops—being proposed to the ERM committee to be added to the list of top enterprise risks. ♦

AICPA RESOURCES

Insider article

■ “How Weak Are Your Firm’s Internal Controls?” *Corporate Finance Insider*, Oct. 6, 2011, tinyurl.com/mmtld76

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OTHER RESOURCE

Website

■ Enterprise Risk Management Initiative, Poole College of Management, North Carolina State University, poole.ncsu.edu/erm

Shooting Straight



How internal auditors can be strategic and collaborative—while maintaining independence and objectivity

by Ken Tysiac

The new imperative for internal auditors is clear.

Companies increasingly expect their internal audit function to take on a more strategic, collaborative role within the business.

At first glance, that seems to be a complex notion. Independence and objectivity safeguards indicate that internal auditors should not be proposing or setting the same strategies they will have to audit. And if they get too close to the same employees in other units they are auditing, it might appear that their objectivity, as defined by Institute of Internal Auditors (IIA) standards, is compromised.

Nonetheless, experts say it's possible for internal auditors to be strategic in their own way and improve their audit procedures through collaboration without impairing their objectivity. Carolyn Saint, CPA, vice president of internal audit for 7-Eleven, said internal audit teams can contribute to strategy by examining the things that need to go right

for strategy to be executed—and the things that could go wrong—and advising management on those.

"It would be helpful to make sure that all the capabilities you are taking as a given are going to be able to be delivered, because they are the foundation of your strategy," Saint said. "So that's one way I think [internal] audit can be more strategically focused."

ly shut the door on internal auditors' value-added tasks and forced them into more of a "police officer" compliance and controls role. But internal auditors are beginning to branch out more and provide additional value in a strategic role again, he said.

Numerous surveys also show that companies are asking internal auditors to be more strategic. A majority (54%) of more

The CAE's role with respect to strategy is to help management think about the risks involved and resources needed when considering a strategy.

Paul Sobel, the chairman of the board for the IIA, said that during the 1990s, many chief audit executives (CAEs) had moved away from focusing solely on controls and concentrated more on consulting and trying to add value to the business in other ways. Sobel said that the events that led to the passage of the Sarbanes-Oxley Act of 2002 temporarily

shut the door on internal auditors' value-added tasks and forced them into more of a "police officer" compliance and controls role. But internal auditors are beginning to branch out more and provide additional value in a strategic role again, he said.

AN ADVISORY ROLE

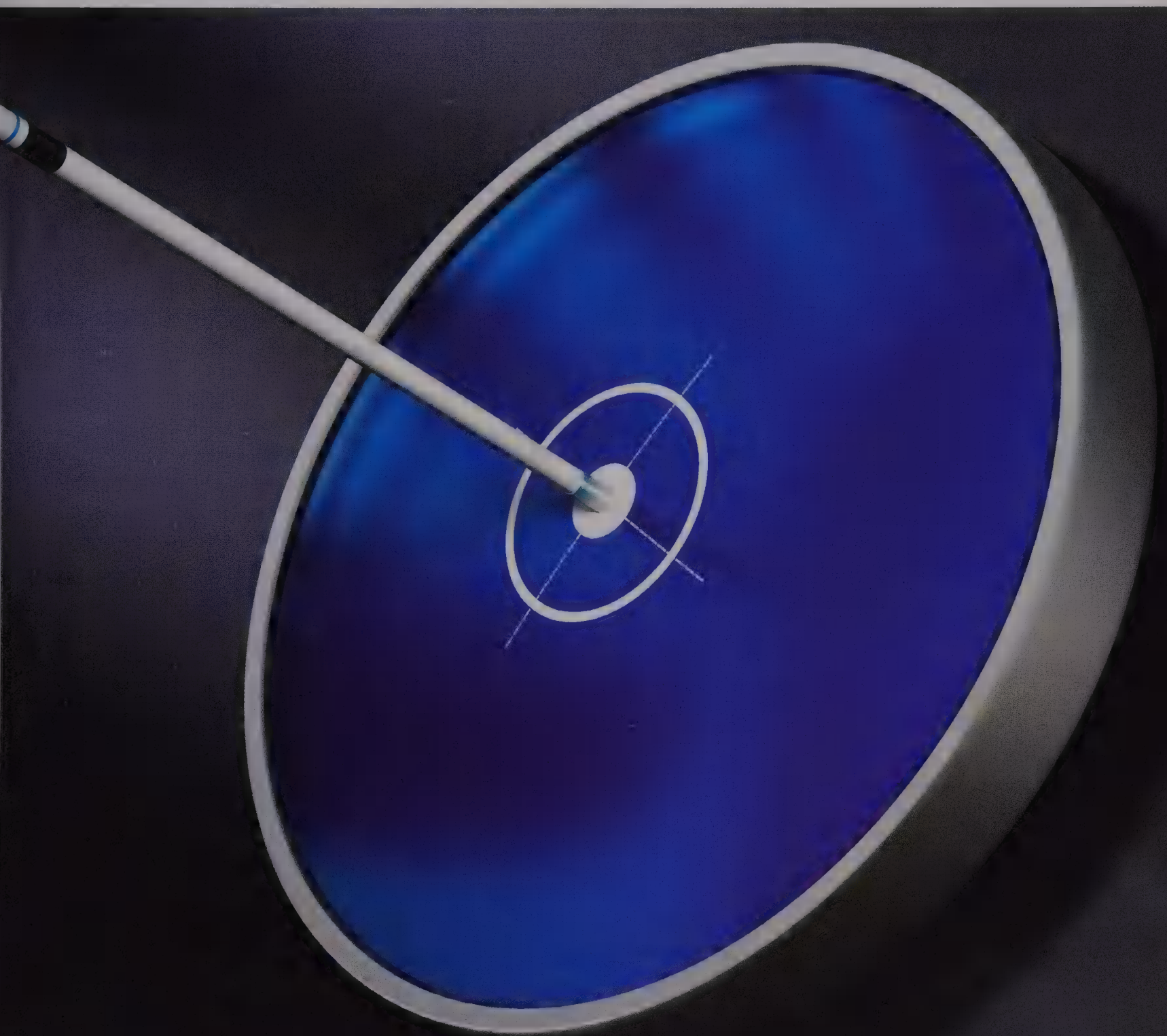
Internal auditors are not supposed to make any decisions about strategy, Sobel said, because that is the responsibility of management and the board. But, according to him, there are two ways for internal auditors to take a strategic role:

■ **Internal auditors can audit strategic risks.** Strategic risks can include competitive pressures that could make the company's products obsolete, changes in customers' expectations or preferences because of socioeconomic shifts,

and an unexpected loss of a key partner in a company's supply chain. Although those strategic risks are not always easy to audit, Sobel said, they need to be on internal audit's radar screen because of the danger they pose to organizations.

■ **Internal auditors can operate in an advisory capacity on strategy.** The CAE's role with respect to strategy is to help management think about the risks involved and resources needed when considering a strategy, Sobel

said. The CAE can provide an assessment of whether the company's capabilities or systems are sufficient to support a strategy. Even then, the CAE doesn't advise management regarding pursuit of a strategy, but rather informs executives and management of options that have not yet been considered. The CAE's role is to direct objective information about resources to management, which can take the advice and decide whether to abandon the strategy, outsource, add more resources or



better technology, or pursue the same path anyway.

Brad Ames, CPA, a director of internal audit for Hewlett-Packard, said internal audit serves in this advisory capacity by aligning its work to examine the potential risks associated with the strategy.

"It's not like you're making the decisions," Ames said. "As long as you're not making the decisions toward what strategy the company is using, you can maintain objectivity."

the organization in a collaborative fashion include:

Strike the right tone. Maintaining the appropriate distance while crafting relationships with other business units is important for internal auditors, according to Saint.

"Get too close to your auditees, and obviously your judgment could at least look like it's being impaired, whether it is or it isn't," she said. "Get too far away, then you're the gotcha, the police squad. That's

know that you're not afraid to use that trump card, if necessary," Sobel said.

But many CAEs (about 37% in North America, according to the IIA survey) report administratively to the CFO. Often this means the CFO approves the CAE's expense report, writes an annual review, and proposes a salary adjustment, which often needs to be approved by the audit committee. And, of course, the CFO controls internal audit's budget.

That's why Sobel said it's better for the CAE to report administratively to the CEO (and 33% do in North America, according to the IIA survey). But Sobel said potential problems with the CFO reporting relationship can be overridden if the CAE is experienced and confident, with direct access to a strong audit committee.

Use standards as a guide. IIA standards (available at tinyurl.com/kydbqvz) provide further guidance with respect to internal audit independence and objectivity. Their requirements include:

- The CAE reporting to a level within the organization that allows internal audit to fulfill its responsibilities.
- The CAE communicating directly with the board.
- Internal auditors having an impartial, unbiased attitude and avoiding conflicts of interest.
- Disclosing any impairment or apparent impairment of independence or objectivity to appropriate parties.
- Internal auditors refraining for at least one year from assessing specific operations for which they were previously responsible.

Adhering to CPA ethics requirements—as well as following IIA standards—can help preserve the independence and objectivity auditors value highly.

Outside the CAE's office, collaboration between internal auditors and other business units also is growing, Ames said. He said it's helpful for internal auditors to coordinate with other governance bodies at the company—such as legal, enterprise risk management, and even external auditors—to position the department and the company to respond to the risks that would inhibit the strategy.

"If the collaboration gives more knowledge in response to strategic risks the company faces, then that's a healthy thing," he said. "But if the collaboration is rationalizing too much risk, then you've got to be careful."

HOW TO COLLABORATE

The experts' tips for maintaining independence and objectivity while serving

out of favor with management teams. ... Nobody is advocating for audit to go back to a day when they were known as the police force or the gotcha squad."

Rely on infrastructure. Proper infrastructure is critical in enabling internal auditors to maintain their independence as they work with other groups, Sobel said.

For starters, in North America 73% of internal audit departments report functionally to the audit committee, according to IIA research published in April. That gives a CAE who is getting undue influence or is being asked to suppress findings the ability to go to the audit committee and explain the problem.

"You have to develop a good relationship with, say, your audit committee chair and develop a trust with your audit committee and make sure your executives

EXECUTIVE SUMMARY

■ **Organizations increasingly are asking internal auditors to play a more strategic, collaborative role.** Internal auditors can audit strategic risks and operate in an advisory role on strategy by informing management of risks involved and resources needed when pursuing a strategy.

■ **Internal auditors are collaborating more with other business units.** This collaboration can be a benefit if it gives internal auditors more understanding of risks, but it can be damaging if it leads internal auditors to rationalize risks.

■ **To maintain the necessary independence and objectivity,**

internal auditors need to keep an appropriate distance as they craft relationships with other business units. Independence and objectivity can be maintained through proper reporting relationships and by following industry standards and CPA ethical guidelines. At times, outsourcing audit

work may be necessary to avoid the appearance of impropriety or a conflict of interest.

Ken Tysiac is a JofA senior editor. To comment on this article or to suggest an idea for another article, contact him at ktysiac@aicpa.org or 919-402-2112.

■ A party outside internal audit over-seeing any assurance engagements for functions the CAE controls.

"It's a fine line for internal auditors, because we understand what [collaboration] means, and we understand the risks that imposes on us," Ames said. "Practicing our standards safeguards close collaboration."

Other safeguards desired by the organization can be written into internal audit's charter (an IIA sample charter is available at tinyurl.com/n7gj6ju). In addition, Ames said, remaining true to the standards required of a CPA can help preserve objectivity. Adhering to CPA ethics requirements—as well as following IIA standards and having a healthy reporting relationship with the audit committee—can help preserve the independence and objectivity auditors value highly.

Outsource when necessary. Cases do arise in which internal auditors have to

recuse themselves. Sobel was working for a company when the practice of backdating and spring-loading of stock options was getting a lot of attention in the news. He decided that the company needed to have an audit done to see if it had a problem with backdating or spring-loading.

Because Sobel received stock options, he declined to have his department get involved in the audit. He had an independent firm perform the audit and report directly to the audit committee.

"No matter how much integrity I think I have, not everybody knows me," Sobel said. "Not everybody can get into my mind. So in that case, I had somebody else do the work."

Preserving that integrity is essential as internal audit seeks to contribute more value to organizations. Without independence and objectivity, Saint said, internal audit's entire value proposition

breaks down.

"It's really the No. 1 tenet that we have to follow," Saint said. "Because if we don't have objectivity, we're not auditors, and then why should anyone listen to us? Then we're analysts. Our professional standards guide us, protect us, and allow us to maintain our unique position as assurance providers and advisers within our companies." ❖

AICPA RESOURCES

JofA articles

- "Checklist: Internal Audit Oversight," Aug. 2013, page 20
- "Checklist: Beef Up Internal Audit," June 2011, page 20

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How to Land an Overseas Assignment



U.S. CPAs can gain international experience even if they don't work for a Big Four accounting firm.

by Sabine Vollmer

Securing an overseas assignment may look like a daunting challenge to a U.S. CPA who isn't working for a Big Four accounting firm with offices worldwide, but it can be done.

The *JofA* sought tips from three experts on how U.S. CPAs can gain international experience. Senior editor Sabine Vollmer talked to Paul McDonald; Pamela Parker-White, CPA, CGMA; and Jason Ramey, CPA.

How difficult is it to gain international experience as a U.S. CPA if you don't work at one of the Big Four accounting firms?

Ramey: It's a lot easier than it used to be

because the middle-market companies are expanding into growth markets like China, India, Brazil, and many other places around the world. At Grant Thornton we send a lot of people overseas and from all of our service lines. Large multinational companies also have opportunities all over the world. It's just a matter of finding the right company, and the timing has to be right.

It can happen at any stage of your career.



If you work for a smaller CPA firm, a lot depends on the firm's client base and if they have larger clients that are going into new markets. Over time, as the firm grows, it may have an affiliate in another country, which could create a short- or long-term opportunity. In the next five or 10 years there should be more opportunities.

McDonald: We're seeing demand for U.S. CPAs from our U.S. clientele's international divisions and subsidiaries, particularly in areas of compliance, tax, and regulatory reporting. For instance, if you have knowledge of U.S. GAAP and IFRS

The Panelists

- **Paul McDonald** is senior executive director at Robert Half, a staffing firm that specializes in placing accountants and finance professionals worldwide.
- **Pamela Parker-White**, division controller and business manager for Babcock & Wilcox's small modular reactor program with the U.S. Department of Energy, was assigned to France for two years in the mid-2000s while she worked for the U.S. branch of Areva, a Paris-based company that offers technological solutions for nuclear power generation.
- **Jason Ramey**, national managing partner in charge of international client services for Grant Thornton LLP, the U.S. member firm of Grant Thornton International Ltd., is responsible for supervising Grant Thornton's global mobility program. He worked in China and still travels extensively.

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and you're a CPA, you are in high demand right now at U.S. corporations either domestically or globally.

Do U.S. CPAs have unique skills that make them attractive overseas?

Ramey: The project-management experience you get out of a U.S. public accounting firm is top-notch. We really do a great job in the U.S. of developing our people for project management, and the partners in member firms around the world highly value that experience.

Forensics and investigative services, including experience with the Foreign Corrupt Practices Act (FCPA), is a high-growth service line now for firms in the BRIC countries [Brazil, Russia, India, and China] and the high-growth markets where there's a lot of corruption. Other skills that may be transferrable to other countries include U.S. audit and accounting skills, transaction advisory and M&A expertise, internal audit skills, and U.S. tax knowledge. Also, transfer pricing can be transferable to some extent.

Grant Thornton and other large firms have shared-services centers in India and other parts of the world where certain work is outsourced. There could be opportunities in these centers requiring U.S. audit, tax, or advisory expertise.

Parker-White: The financial skills are probably comparable across countries, but U.S. CPAs tend to have a broader background. In the U.S. we used to be very focused on just closing the books, doing the financial statements. We've gotten away from being pure numbers crunchers. Now we do that plus we're more general management and business partners, and that adds a valuable skill that you don't necessarily get from more financially focused accountants.

What do employers look for on a résumé when considering hiring a CPA for an overseas job?

Ramey: If you have experience working for a public company listed in the U.S., it could be very attractive on a résumé. Experience with U.S. GAAP, PCAOB, and

SEC rules, as well as the Foreign Corrupt Practices Act, can be really attractive to public accounting firms. Any internal audit experience is a good skill set to highlight. Obviously, any study abroad or any language skills would be important to note.

Significant knowledge of an industry can be helpful. For example, the automotive industry takes people from the U.S. to other countries around the world such as Germany, China, and Mexico. Energy experience could take someone from the U.S. to Russia or Canada.

McDonald: Technically, I would say IFRS, tax, government risk, and compliance. They are looking at your technical experience within their marketplace, where they want to do business. They are looking at certifications, such as CPA, the CGMA, or the CA [Chartered Accountants]. If it's in the banking world, they are looking at work experience with Basel III, the worldwide regulatory discipline within financial services.

Parker-White: They look for experience, and they are going to look for openness and cultural awareness. It's not necessarily people's technical competence, it's more a matter of will they be able to adapt. So people who have already shown a willingness to travel and a curiosity about other cultures will have an easier time adapting.

How important is it to speak the local language or to speak a second language?

Ramey: It is nice to have a language skill, but it may not be as important as having the management or technical experience of a U.S. CPA. The lower level you are, the more important it is to have a language skill in the country you are working in.

McDonald: It's always a benefit to be multilingual. It's not always mandatory for CPAs to be multilingual. The business language of English is global. But if you are in a social setting and understand what is being spoken on a casual or business-casual basis, it's a plus. English plus Spanish. English plus some of the Asia-Pacific languages.

Parker-White: If you don't speak a second language, it might be helpful to look at English-speaking countries. For example, you've got a country like India, and pretty much everybody speaks English.

Are some countries more suited for a U.S. CPA seeking work overseas than others?

McDonald: We're seeing demand in South America. We're seeing demand in Asia, Western Europe inclusive of the U.K. If we look at the Middle East, construction and health care are growing, and there is demand for CPAs with construction and health care backgrounds.

Is the interview process different for overseas jobs?

Ramey: The interview process is probably longer, more people are involved, and the questions might go into different areas than if it didn't involve international work. It might not just be their technical skills, but there are going to be soft skills you're looking for. Someone who may work in Brazil may not work in China or Singapore. So you have to drill down further.

It's a huge investment, so it's extremely important from a business-case perspective, but also for the employee's personal situation, that you find the right person and that it's right for that person's career and family.

McDonald: Applicants for new jobs should always expect the unexpected when they go for the interview. Know the company the best that you can, and if there is information in the public domain, read up on it. Do your homework. Do your research as well to find out who's in charge of finance, who's in charge of the area you're interviewing for. Are they a CPA? Where did they go to school? From there you have to be open for new information coming your way. You may have applied for one position, but you get there and they say, "Oh, not only do we have that position, but there is another position available that you might be interested in or qualify for." So expect the unexpected.

Parker-White: They will ask different questions. For example, when I inter-

viewed at Areva, at the time there wasn't even a possibility of me working overseas, but they were a French company. My boss told me later that one of the reasons they hired me was because I had traveled to China, just on my own, and that not too many Americans did things like that. He thought that indicated a willingness to be open to other experiences. In an interview for a domestic job, why would they care where I go on vacation?

Is there any other advice you can offer a U.S. CPA who wants to work abroad?

McDonald: If you're interested in working in a company that is involved in international business and you don't have the experience in your current company, volunteer within your organization for project-related business that might give you the experience and the exposure.

Consider gaining language skills through an online course. Gain a certification. Understand and study up on any new regulatory or compliance impacts within the country or particular region of the world you're interested in.

Parker-White: If you get international experience early in your career, then it will really help you with the rest of your career, no matter where you go, because everything is so much more multinational now than it used to be. At the end of your career, though, a lot of times it's easier to go because your children are grown and it's time for a nice adventure before you retire.

Ramey: If you want to work abroad, try to be patient and seek the right opportunity that works for your career path. It could possibly come early in your career or even at the end. For example, partners or employees who have retired from CPA firms can offer a lot of value, especially in developing countries where both management and technical experience is needed. ♦

Sabine Vollmer is a JofA senior editor. To comment on this article or to suggest an idea for another article, contact her at svollmer@aicpa.org or 919-402-2304.

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- "How to Network and Find New Clients Across Borders," Oct. 2013, page 32
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- "Global Mobility: U.S. CPA Credentials Travel Around the World," July 2013, page 46
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What to Do When a Client Has an Undisclosed Foreign Account

Weighing the options requires a
thorough understanding of risks.

by Scott H. Novak, Esq.



C PAs often have clients with an interest in or signature authority over a foreign account. The IRS has emphasized compliance in reporting requirements for U.S. owners of foreign accounts, but many taxpayers may still not know their responsibilities and liabilities. This article outlines these responsibilities and liabilities and describes current enforcement efforts.

DISCLOSURE RESPONSIBILITIES

A taxpayer who has an interest in or signature authority over certain foreign accounts must inform the government of the existence of the account each year by checking the box in Part III, line 7a, on Schedule B, *Interest and Ordinary Dividends*, of the taxpayer's Form 1040, *U.S. Individual Income Tax Return*. The taxpayer must also attach Form 8938, *Statement of Specified Foreign Financial Assets*, providing details about the foreign accounts if the account balances and the value of other foreign financial assets total more than \$50,000 on the last day of the year or more than \$75,000 at any time during the year for single filing status. For married taxpayers filing jointly, the threshold amounts are \$100,000 and \$150,000, respectively. Taxpayers with foreign accounts with an aggregate value of more than \$10,000 during the calendar year must also file FinCEN (Financial Crimes Enforcement Network) Form 114 (formerly TD F 90-22.1), *Report of Foreign Bank and Financial Accounts* (FBAR). This form is filed electronically with the Treasury Department's BSA (Bank Secrecy Act) E-Filing System (accessible at tinyurl.com/qo9apa) not later than June 30. No extensions are available.

Over the past several years, many taxpayers with foreign accounts have erroneously checked "no" on line 7a of Schedule B, Part III, and have not filed Forms 8938 or FBARs as required. A taxpayer who signs a return without disclosing the existence of a foreign account may well have committed perjury, and hiding assets

in an offshore account may constitute tax fraud.

HOW DOES THE IRS FIND FOREIGN ACCOUNT OWNERS?

The U.S. Treasury and Justice departments have become aggressive in going after foreign banks and other facilitators to get information about U.S. account owners. The first major target that they had success with was UBS in Switzerland, which ultimately turned over the names of more than 4,000 U.S. taxpayers with hidden Swiss accounts. UBS also agreed to pay a \$780 million fine as a result of an investigation and its guilty plea to helping Americans evade taxes.

Switzerland's oldest bank, Wegelin & Co., paid \$74 million in fines, restitution, and forfeitures and agreed to cease operations as a bank. More banks in Switzerland followed, and the program has been extended to many other countries and areas, including Israel and the Caribbean. As these banks enter into settlements with the U.S. government, they often agree to hand over the names of their U.S. customers.

In August, the United States and Switzerland signed an agreement that provides for fines in exchange for nonprosecution agreements for banks that facilitated American tax evasion. As these banks enter into settlements with the U.S. government, they, too, will hand over the names of their U.S. customers.

Another recent development was the indictment of Edgar Paltzer, an American-educated Swiss attorney who not only helped many Americans evade taxes through foreign accounts but had control over and access to many European bank vaults holding assets and valuables that were being hidden from the government. He faces up to five years in prison, but the sentence is expected to be less because he is cooperating with authorities. The information Paltzer is providing gives the IRS a better picture of the methods used to evade taxes by transferring cash and assets to foreign accounts and locations.

Sensational stories of high-profile foreign account cases have caused many

taxpayers with foreign accounts to step forward under the IRS's Offshore Voluntary Disclosure Initiative (OVDI). As of December 2012, the IRS had collected more than \$5.5 billion in back taxes, interest, and penalties from more than 39,000 taxpayers under the program, the U.S. Government Accountability Office (GAO) reported (GAO Rep't No. 13-318).

OPTIONS FOR TAXPAYERS WITH UNDISCLOSED FOREIGN ACCOUNTS

Taxpayers who have an unreported foreign account must decide which of three actions to take: do nothing and hope for the best, make a quiet disclosure or a new disclosure, or enter the OVDI.

Do nothing and hope for the best. This is, obviously, a high-risk option. Treasury and Justice continue to hone their skills not only in going after individuals who have foreign accounts but also in securing names of U.S. account holders from foreign banks. Nearly every FBAR matter that is resolved requires the taxpayer to sit down with the IRS to answer questions. To the extent that the Fifth Amendment right against self-incrimination is not invoked, the IRS gets information at each of these meetings that can help it find and prosecute those who helped Americans open foreign accounts and hide income from the government. The facilitators, as part of their own settlements, often turn over the names of U.S. owners of hidden foreign accounts. Considering the increasing likeli-

hood that the IRS will eventually find foreign account owners, stepping forward and doing something is likely preferable.

Quiet disclosures and new disclosures. With a quiet disclosure, the taxpayer files amended income tax returns and FBARs going back as far as the statute of limitation requires, generally three or six years. The benefit of a quiet disclosure is that the taxpayer is not coming forward under the OVDI, thereby avoiding even the reduced penalties imposed under the program. In such a case, the taxpayer merely amends his or her returns to bring them into compliance with the law and completes the necessary FBARs. This may have worked for many people over the last several years, but it is becoming a high-risk tactic, too. Taxpayers who reported the income on a foreign account but failed to file FBARs are likely to fare better from a penalty perspective than those who did neither.

The GAO report cited above suggests that quiet disclosures have been rampant. It determined that from 2003 to 2008, 10,595 taxpayers made quiet disclosures. Of those, 3,386 taxpayers made late or amended filings for multiple tax years—94 of them for all six years. The IRS is also aware of the problem, though it had estimated a much smaller number of quiet disclosures. The GAO recommended that the IRS begin to look for these amended returns to better detect quiet disclosures and impose penalties where warranted.

Among other things, the GAO said the IRS should explore options to more effec-

tively detect and pursue quiet disclosures and analyze first-time offshore account reporting trends to catch people trying to avoid paying what they owe.

First-time offshore account reporting, or a "new disclosure," is another tactic taxpayers have used. The taxpayer simply makes the disclosure on a current return and hopes not to be discovered for prior years. This has worked for some, in much the same way that quiet disclosures have worked for others. The GAO noted that the number of taxpayers checking the box on Schedule B that indicates the existence of a foreign account has more than doubled from 2003 to 2010, to 515,635. Strikingly, the number of FBARs filed more than tripled to 618,134 from 2003 to 2011 and more than doubled between 2009 and 2010.

The IRS will likely begin to take a closer look at first-time FBAR filers and at returns where line 7a of Schedule B is checked for the first time. In addition, a much higher level of audit activity can be expected where amended returns are filed that indicate the existence of a foreign account.

The IRS OVDI. The IRS has had three iterations of the OVDI. The first iteration offered the lowest level of penalty (20%). The current version sets the penalty at 27.5%. Under the program, the account owner must also agree to be taxed on the prior eight years of income in the account rather than three or six.

Why would owners of foreign accounts step forward under the voluntary program when they are virtually assured that in ad-

EXECUTIVE SUMMARY

■ **Taxpayers with an interest in or signature authority over foreign accounts** generally must disclose them on their annual tax returns and file FinCEN Form 114 (formerly TD F 90-22.1), *Report of Foreign Bank and Financial Accounts* (FBAR), with the Treasury Department annually by June 30.

■ **The IRS is increasingly likely to detect noncompliance** as it gains greater cooperation from for-

eign financial institutions and analyzes returns for new and "quiet" disclosures. Qualifying taxpayers wishing to limit their exposure may enter the IRS's Offshore Voluntary Disclosure Initiative (OVDI).

■ **If taxes on income from undisclosed foreign accounts is unpaid**, taxpayers in the OVDI will likely pay eight prior years' back taxes on the income, plus a 20% accuracy penalty, and an addition-

al penalty of 27.5% of the highest account value. In return, they will not be subject to criminal prosecution or liable for the potentially much greater penalties that could be imposed, especially if the non-compliance is willful.

■ **However, some clients may be best advised to opt out of the OVDI** if, for instance, they have unreported foreign account income but no tax deficiency, and

in some instances, for nonwillful failure to file FBARs.

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To comment on this article or to suggest an idea for another article, contact Paul Bonner, senior editor, at pbonner@aicpa.org or 919-402-4434.

dition to eight years of federal income tax on the account earnings, they will be required to pay a 20% accuracy penalty on the amount of income tax due, interest, and 27.5% of the highest account value as an additional penalty? Under the voluntary program, the potential for criminal prosecution is removed. In addition, outside the voluntary program, the penalties can be far higher, as much as the greater of \$100,000 or 50% of the highest account value for each violation. In most cases, this larger penalty has been applied to the highest account value over the last three or six years, depending on which statute of limitation applies (see Internal Revenue Manual (IRM) §4.26.16.4.7(4)). But see *Zwerner*, No. 1:13-cv-22082-CMA (S.D. Fla., complaint filed 6/11/13), for a case where the government is attempting to collect multiple-year maximum civil penalties in an FBAR matter.

The first step when a client desires to enter the voluntary program is to write to the IRS Criminal Investigation Division (CID) to get the client precleared to enter the program. A client whose bank has already provided the IRS with the client's information is not likely to receive clearance. If the client is precleared to enter the program, the next step is to amend the last eight years of income tax returns to include any previously unreported income from the foreign account.

These items must be submitted when disclosing a foreign account, generally within 45 days after receiving a preclearance letter:

- Copies of original returns (and amendments) filed for the years covered by the voluntary disclosure.
- Amended returns and certain tax return schedules for the years covered by the voluntary disclosure.
- A signed offshore voluntary disclosure letter with the necessary attachment.
- A check for the tax, interest, and penalty computed on the account.
- A completed foreign account or asset statement if the information

on the statement was not already disclosed on the offshore voluntary disclosure letter.

- Completed penalty computation worksheet.
- Signed extension of time to assess tax (including penalties and FBAR penalties).
- Completed FBARs.
- For applicants disclosing offshore financial accounts with an aggregate highest account balance in any year of \$500,000 or more, financial account statements showing all account activity during the voluntary disclosure period. For applicants disclosing offshore financial accounts with an aggregate highest account balance in any year of less than \$500,000, copies

determination is critical for the assessment of civil penalties. Willful penalties, as described above, can be as high as the greater of \$100,000 or 50% of the account value. This is in addition to back taxes, interest, and an accuracy penalty that is 20% (or in some cases 40%) of the back taxes owed. A nonwillful violation generally calls for a penalty of up to \$10,000 per year of violation for the years that remain open under the statute of limitation. In some cases, the IRS may agree to waive penalties altogether, though this appears to be rare. So what separates a willful violation from a nonwillful violation?

The test for willfulness is whether there was a voluntary, intentional violation of a known legal duty (IRM §4.26.16.4.5.3.1). The IRS has the burden of establishing willfulness (IRM §4.26.16.4.5.3.3). Willful-

The IRS will seek to determine whether the foreign account violations were willful and, if so, whether the case is worthy of criminal prosecution.

of offshore financial account statements reflecting all account activity for each of the tax years covered by the voluntary disclosure must be available upon request.

It should be noted that in most instances, the taxpayer will be required to sit down with the IRS agent assigned to the taxpayer's case in a meeting that might also include a supervisor and an attorney from the IRS District Counsel's office.

FBAR VIOLATIONS OUTSIDE THE OVDI

If the IRS has already obtained a taxpayer's foreign account information from a foreign institution, he or she will likely be barred from the voluntary program. In addition, there could be strategic reasons not to enter the program.

The IRS will seek to determine whether the foreign account violations were willful and, if so, whether the case is worthy of criminal prosecution.

Willful vs. nonwillful violations. This

ness is shown by the person's knowledge of the reporting requirements and conscious choice not to comply. In an FBAR situation, the only thing that a person needs to know is that he or she has a reporting requirement. If a person has that knowledge, the only intent needed to constitute a willful violation of the requirement is a conscious choice not to file the FBAR (IRM §4.26.16.4.5.3.5). Several examples of what the IRS considers to be a willful violation can be found in IRM Section 4.26.16.4.5.3.8.

While the standard of proof the IRS must meet to prove that an FBAR violation is willful formerly appeared to be one of clear and convincing evidence (see IRS Chief Counsel Advice (CCA) 200603026), the less strict preponderance-of-the-evidence standard was applied by the court in *McBride*, No. 2:09-cv-378 (D. Utah 2012).

Willful violations are perhaps more likely to be found where the account owner put the funds in the account, used the funds in some manner, and actively

participated in keeping the account hidden from the authorities. Nonwillful violations may more likely be found where the taxpayer did not put the funds in the account, exercised no control over the funds, did not use any of the funds, and was unaware of reporting requirements. Clearly, a large spectrum of behavior between these two extremes comes down to the facts and circumstances of a particular situation. Defending a client against the higher penalties associated with willfulness calls upon the practitioner's skills and abilities.

Can a taxpayer avoid the finding of a willful violation by claiming that he or she did not know about the foreign account filing requirements? For a time, it looked as if one district court was going in this direction (see *Williams*, No. 1:09-cv-437 (E.D. Va. 9/1/10)). On the government's appeal, however, the Fourth Circuit held (*Williams*, 489 Fed. Appx. 655 (4th Cir. 2012)) that the district court had clearly

erred in finding that Williams did not willfully violate 31 U.S.C. Section 5314, the federal law that requires individuals to report to the IRS annually any financial interests they have in any bank, securities, or other financial accounts in a foreign country.

In *Williams*, the taxpayer, Bryan Williams, checked "no" on Schedule B, Section III, line 7a, and filed no FBARs. He claimed that he was unaware of the filing requirements and never read the actual words on his return. The Fourth Circuit found that the taxpayer made a conscious effort to avoid learning about the reporting requirements. The court found that signing his 2000 federal income tax return was prima facie evidence that the taxpayer knew the return's contents. Williams's false answers on both the tax organizer he filled out for his tax preparer and his income tax return further indicated conduct that was meant to conceal or mislead on sources of

income or other financial information, the court found. In such a situation, "willful blindness" may be inferred, the court said, where "a defendant was subjectively aware of a high probability of the existence of a tax liability, and purposely avoided learning the facts" (quoting *Poole*, 640 F.3d 114, 122 (4th Cir. 2011)).

According to the court, at a minimum, Williams's actions established reckless conduct, which satisfied the preponderance-of-the-evidence burden of proof requirement for the civil FBAR penalty for willfulness.

McBride similarly dealt with willfulness in the context of FBARs. The taxpayer, Jon McBride, had a company that was operating overseas. He retained the services of a firm that designed strategies to allow its clients to avoid reporting income and their ownership in assets by having its clients' assets held by nominees holding legal title of shell corporations and foreign bank accounts. McBride accessed the funds through sham lines of credit. The district court found that McBride had an interest in foreign accounts and that he willfully failed to report his interest in them.

By signing his returns, McBride was said to have imputed knowledge of the requirement to file FBARs, since the tax returns contained a plain instruction informing individuals that they have the duty to report their interest in any foreign financial or bank accounts held during the tax year. The court acknowledged that willful blindness satisfies a willfulness standard in both civil and criminal contexts. In *McBride*, the court also reasoned that the willfulness standard can be satisfied through the taxpayer's reckless disregard of a statutory duty. Simply not knowing about the foreign account reporting requirements is not enough to defeat a finding of willfulness.

The court noted in *McBride* that subjective knowledge was not required for the taxpayer to have willfully failed to comply with the FBAR requirements, because the taxpayer acted in reckless disregard of the



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known or obvious risks created by his involvement with foreign accounts. Drawing an analogy with the trust fund recovery penalty standards under Sec. 6672, the court stated that “a responsible person is reckless if he knew or should have known of a risk that the taxes were not being paid, had a reasonable opportunity to discover and remedy the problem, and yet failed to undertake reasonable efforts to ensure payment” (quoting *Jenkins*, 101 Fed. Cl. 122, 134 (2011)).

In the *Williams* and *McBride* cases, the courts noted that both taxpayers failed to discuss their financial strategies involving millions of dollars with their accountants. This was viewed by the court as significant evidence of willfulness or at least recklessness and willful blindness.

OPTING OUT OF THE OVDI

There might be good reason to opt out of the OVDI. To see some examples that the IRS believes to be appropriate opt-out opportunities, see Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers, Question 51.1, available at tinyurl.com/9oolgde. Opting out is at the sole discretion of the taxpayer and is an irrevocable election. Examiners are advised that taxpayers should not be treated in a negative fashion merely because they choose to opt out.

Once an opt-out is elected, the taxpayer can expect a full audit. The IRS will remind the taxpayer in writing of the continuing responsibility to cooperate under Criminal Investigation's Voluntary Disclosure Practice and will instruct the taxpayer to provide a written statement setting forth the facts of the case, a recommendation of the penalties that should apply, and the rationale for the penalty recommendations within 20 days of receiving the letter from the IRS. (See IRS memorandum, “Guidance for Opt Out and Removal of Taxpayers from the Civil Settlement Structure of the 2009 Offshore Voluntary Disclosure Program (2009 OVDP) and the 2011 Offshore Voluntary Disclosure Initiative (2011 OVDI)” (June 1, 2011).)

Checklist for Foreign Accounts

Initial inquiry:

- Does the client have a foreign account?
- If yes, is it the type of account that is covered by 31 U.S.C. Section 5314?
- If applicable, has the client properly completed Form 1040, Schedule B, *Interest and Ordinary Dividends*, Part III, Line 7a?
- Has the client annually reported the income from the account?
- Has the client filed FinCEN Form 114 (formerly TD F 90-22.1), *Report of Foreign Bank and Financial Accounts* (FBAR)?
- Has the client filed Form 8938, *Statement of Specified Foreign Financial Assets*, with his or her federal income tax return?
- Has the IRS already contacted the client about the foreign account?

For a client with an unreported foreign account who has not been contacted by the IRS:

- How long has the client had the account?
- What was the source of the funds?
- Was the account inherited?
- Did the client use funds in the account or actively manage it?
- Is the client a nominal or beneficial owner of the account?
- Does an entity own the account? If yes, what is the client's ownership of or involvement in the entity?
- Upon your analysis, does it appear reasonably likely that the IRS could sustain a successful criminal prosecution against the client?
- Upon your analysis, does it make sense to enter the Offshore Voluntary Disclosure Initiative (OVDI)?
- Despite the risk, is there logic in considering a quiet disclosure rather than entering the OVDI?
- Is there a reason to opt out of the OVDI?
- Are there other issues on the client's federal income tax return that would not stand up to an IRS audit?

Additional considerations when the client has been contacted by the IRS or is denied access to the OVDI:

- Has the client disclosed the account to his or her accountant or tax preparer?
- Does it appear that the IRS could sustain a willfulness penalty against the client?
- Do the facts support a negligence penalty?
- Do the mitigation guidelines apply?

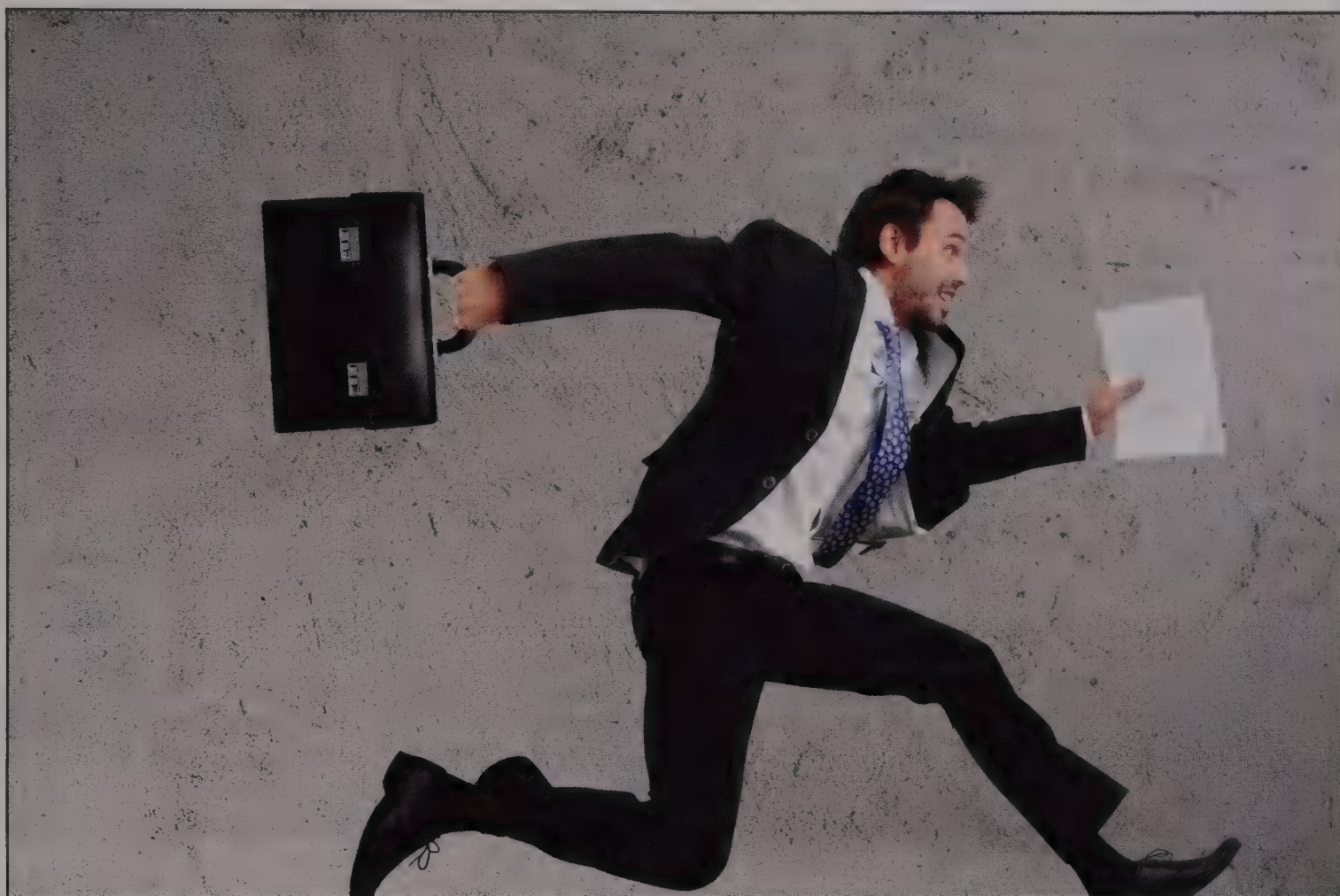
FBAR VIOLATION MEETINGS WITH THE IRS

Meetings with the IRS concerning FBAR violations create a quandary for the practitioner. The IRS will generally not settle FBAR cases without having a face-to-face meeting with the taxpayer. A taxpayer who refuses is deemed to be uncooperative, and this may have an impact on penalties (see

IRM Exhibit 4.26.16-2 (7/1/08)). On the other hand, if the attorney advises the client to attend the meeting and speak freely, will a bad result raise a potential malpractice issue? If the client is advised to not agree to the meeting, the IRS will move to compel the meeting. While the IRS can ultimately force the client to meet, it cannot force him or her to speak.

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Now a choice must be made. One alternative is for the client to plead the Fifth Amendment right against self-incrimination at such a meeting, though doing so will almost certainly lead to greater IRS scrutiny. If the client has a good story to tell, this is likely the time to tell the story if there is a good chance that, based on the facts, the practitioner thinks that non-willful penalties are likely to apply. If the client is going to speak at this meeting, he or she must be candid and truthful.

This is yet another area where the practitioner's experience and judgment play a

large role. This may be a good time for the client to engage an attorney if he or she has not done so already. In any event, the client must make the ultimate decision about whether to have the meeting. All communications with the client on this topic should be in writing, for the practitioner's protection (see the sidebar, "Checklist for Foreign Accounts," for a step-by-step framework for assessing the client's circumstances and recommending a course of action).

MAKING A CLEAR ASSESSMENT OF THE FACTS

Where a taxpayer was clearly willful or reckless, the voluntary program may be the best option if the IRS has not found the taxpayer before he or she attempts to enter the program. This tack will limit penalties and likely help the client avoid criminal prosecution. But where willfulness and recklessness do not appear to be the cause of the reporting failures, careful consideration should be given to opting out of the voluntary program.

The IRS can determine that no penalty is warranted and issue a warning letter, though again, it rarely does. Rather, it will look to determine if there was some level of negligence in a particular matter. Negligence can be inferred in some instances by the sophistication or education level of the taxpayer. With a large account, \$10,000 per year for each year that the FBAR statute of limitation is open may be far more palatable than the penalty that would be paid under the voluntary program. Another consideration is that the FBAR examiner has a certain amount of discretion. The IRS has developed penalty mitigation guidelines to ensure some level of consistency in the treatment of similarly situated taxpayers.

According to IRM Section 4.26.16.4.6.1, to qualify for mitigation, a person must meet four criteria:

1. The person has no history of criminal tax or BSA convictions for the preceding 10 years, as well as no history of past FBAR penalty assessments.
2. No money passing through any of

the foreign accounts associated with the person was from an illegal source or used to further a criminal purpose.

3. The person cooperated during the examination.
4. The IRS did not determine a civil fraud penalty against the person for an underpayment of income tax for the year in question due to the failure to report income related to any amount in a foreign account.

There is a risk of criminal prosecution when a taxpayer has a hidden offshore account. This is another reason to consider engaging an attorney early in the process. In terms of criminal prosecution and incarceration in offshore cases, it appears that judges are handing down shorter sentences than recommended under federal guidelines, with the average sentence being about half as long as in some other types of tax cases.

Since Treasury and Justice began their heightened scrutiny of offshore account activity roughly four years ago, they have charged at least 71 taxpayers criminally. The average sentence handed down in offshore cases has been less than 15 months. In contrast, the average sentence in tax-shelter schemes has been 30 months over the past three years. Three-quarters of taxpayers charged in offshore account cases have pleaded guilty. Prison sentences have been handed down about half the time (see "Leniency for Offshore Cheats," *Wall Street Journal*, May 5, 2013).

AN EVER-WIDER NET

The IRS will continue to develop its capabilities in finding and prosecuting foreign account cases. The new agreement with the Swiss and the fact that the IRS insists on interviewing taxpayers indicates that there is a high risk that foreign banks and taxpayers will name others involved in foreign account facilitation, thus allowing Treasury and Justice to cast an ever-wider net. An adviser must look at the facts of each case and determine which path to suggest to a client, because doing nothing is no longer a viable option. ♦

AICPA RESOURCES

JofA article

- "FATCA: A New Era of Financial Transparency," Jan. 2013, page 52

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CPA FIRM SUCCESSION: SOLIDIFYING THE FUTURE

Seven Steps to Closing a Succession Sale

Sixth in a series: Upfront work plays key role in bringing a deal to a successful conclusion.

by Joel Sinkin and Terrence Putney, CPA

Key to a successful merger or acquisition is keeping the process moving. For firm leaders, there is rarely any item of greater importance than a merger they are pursuing. The adage “time kills all deals” is absolutely true with mergers, and this is why:

- **Adversarial positions:** Naturally, both parties to the deal are looking for the best possible terms. For example, the seller wants to receive the highest compensation possible, and the buyer wants to pay the least. Successful deals depend on the parties working together for a common positive outcome. However, the longer negotiations last, the more likely the talks will develop an adversarial tone.
- **When a successor firm is slow to move the process along,** many firms seeking an acquisition wonder two things:
 - If this is not a priority for the successor, am I talking to the right firm?
 - Does the successor firm have the capacity to take on this venture?

About the Series

Powerful forces are transforming the accounting profession in the United States. The Baby Boomers are heading into their retirement years. Baby Boomer CPAs are in charge of most U.S. accounting firms, and most U.S. accounting firms don't have a signed succession plan or practice-continuation agreement in place.

The *JofA* is presenting a succession series designed to help accountants navigate the new landscape of succession and mergers. This month's installment, the sixth in the series, looks at the seven steps to complete a merger or sale for succession.

(Neither of these perspectives, which are inevitable with delays, leads to a good outcome.)

- Every time someone reads a contract, it has new meaning, and, all of a sudden, issues that were previously resolved become new problems. That leads to more delays and more conflict.
- Some things can't be kept under wraps forever. Many times word gets out that a firm is “in play.” This can lead to competitors and constituents acting on incomplete and false information.

THE SEVEN STEPS

Following are seven steps for deal management designed to keep the process moving. This is not to suggest that one should rush to get a deal done, throwing caution to the wind. Rather, the parties need to focus and commit to the process until they realize they have a viable deal or they don't. This improves the probability of closing a deal that should be done and avoids wasting time and resources on one that wasn't meant to be.

Step one. The firm seeking to merge up or sell should prepare a generic practice

information sheet. Generic, in this case, means that the document should not disclose client names and other confidential information. The sheet should include strategic goals for the affiliation and the operating characteristics of the selling

other firm to determine whether there is a foundation to move forward.

Step two. The parties should identify “must-haves” and be ready to discuss them. Often there are certain items that would be deal breakers if they are not

Successful deals depend on parties working together for a common positive outcome. Longer negotiations are more likely to become adversarial.

firm, including fee volume, services rendered, types of clients, billing rates, headcount for staff and owners, profit margin, and other information necessary for a potential purchaser to determine initial interest.

Strategic goals should include near-term transition plans for partners, if applicable, and possibly growth, expansion, and other upside opportunities that can be accomplished through a merger. For example, a four-partner firm might have one partner seeking immediate succession, another who is looking to slow down in five years, and two younger partners who are seeking long-term growth but lack the capacity to replace the partners with near-term transition plans. The objective of this summary information is to share what the selling firm has and what it believes a successful merger would look like. This allows the

handled in a way that meets the selling firm’s needs. The authors recommend those items be discussed upfront with the other party so they don’t come up late in the process, after extensive negotiations, to kill the deal. Examples of must-haves include unexpired leases, location requirements, status of merging partners, compensation, other deal terms, staff retention, and other operating requirements.

This requires keeping in mind three things:

1. The more must-haves a firm presents, the fewer firms are likely to be interested in a deal. Some of these must-haves can affect a firm’s value.
2. There are sometimes ways that haven’t been thought of yet to overcome an issue considered a must-

have, but the firm must be open to finding alternative win-win outcomes.

3. The firm needs to categorize “must-haves” into (a) what it really must have, (b) what it strongly prefers, and (c) what it would like to have.

The name of the successor firm is sometimes listed as a “must-have” for firms seeking an upstream merger or sale. There may be valid reasons for that to be on the list, but the authors have found very few instances where changing a firm’s name because of a merger has had any discernible impact on the deal’s success. Keeping a name does not replace the need for a comprehensive transition plan whereas a proper transition and communication strategy almost always overcomes any issues associated with a name change.

Must-haves that are easy to explain (such as unexpired leases) are best included in the summary information, while more complicated ones are best discussed in the initial meeting.

Step three. The firm should define what its merger partner/successor should look like. This involves using the four C’s, as described in detail in the third article of this series, “How to Select a Successor,” *JofA*, Sept. 2013, page 40. Here is a brief recap of the four C’s:

■ **Chemistry:** If you don’t want to eat ❖

EXECUTIVE SUMMARY

■ **Among the biggest threats to accounting firm merger deals are delays.** It’s imperative to keep the process moving because the passage of time increases the likelihood of events occurring that could scuttle the deal, including an adversarial tone developing, late changes to contracts provoking a dispute, questions being raised about the importance of the deal to the other party, and word leaking of the deal discussions.

■ **Firms seeking to sell or**

merge into another firm should prepare a generic practice information sheet. The sheet should cover strategic goals for the merger as well as information about the firm’s fee volume, services, types of clients, billing rates, headcount, and profit margin, among other items. The sheet should not include confidential information.

■ **Selling firms also should identify “must-haves” upfront** and have a profile in mind for the ideal successor to any partners who will be cashing out. These

items should be covered in initial merger meetings.

■ **Firms should discuss deal terms early in the merger talks before extensive due diligence takes place.** Firms often complete due diligence first and then discover deal breakers when terms are discussed. Firms that create a foundation for a deal upfront can still pull out if something material is discovered in due diligence.

■ **The last of the seven steps in an accounting firm merger is**

closing the deal. This is the time to bring in the lawyers.

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To comment on this article or to suggest an idea for another article, contact Jeff Drew, senior editor, at jdrew@aicpa.org or 919-402-4056.

lunch with someone regularly, don't merge with that person. In other words, if the partners don't personally like the people they are talking to, why would their staff and clients like them?

- **Capacity:** Understanding the goals for a deal leads to knowing the capacity issues required of the other firm. For example, if one partner is slowing down soon, the successor firm must have the capacity and skill set to replace that partner.
- **Continuity:** Most accounting firms have their client base because their clients are *comfortable* with their people and approach to service. Clients tend to focus on fees, how services are provided, the level of hand-holding, and specialties, to name a few. A successor firm must be able to avoid the clients' viewing the merger as a loss of a prior firm and instead promote the gain of the combined firm.
- **Culture:** This term is used a lot but remains a vague concept for many. Culture can be thought of in three

ways: (1) What's it like to work here?; (2) What's it like to be a client here?; and (3) What's it like to be a partner here? A selling firm needs to consider if a merger candidate or buyer can cut the mustard in all three areas.

Step four. Before any meetings occur, information and goals should be shared with, and preliminary information obtained from, the other firm. This qualifies both firms for each other. Now attention

If several firms are courting the selling firm, the field should be narrowed to ones the selling firm likes and those that like the selling firm. The selling firm should obtain a nonbinding offer from the firm(s) it likes of how the firms would come together. It is not unusual for this to happen as early as after one initial meeting and certainly after no more than two.

Many firms think they need to perform due diligence before making an

The firms should share what they believe success looks like and find out what their strategic goals are for the merger.

can be turned to the four C's and the must-haves in initial meetings. The firms should share what they believe success looks like and find out what their strategic goals are for the merger. What do they intend to accomplish? What is their business plan for this merger?

Step five. The potential deal terms should be addressed as soon as possible.

offer. However, it should be kept in mind that every step described above is part of due diligence. In step one, the selling firm has already told the other firm what it has and what it wants. Other critical issues can be addressed in the form of additional inquiries. It is appropriate to assume the information and responses are accurate. The nonbinding offer should describe

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CPA Firm Succession series

- Part 5: "How to Value a CPA Firm for Sale," Nov. 2013, page 30
- Part 4: "A Two-Stage Solution to Succession Procrastination," Oct. 2013, page 40
- Part 3: "How to Select a Successor," Sept. 2013, page 40
- Part 2: "The Long Goodbye," Aug. 2013, page 36
- Part 1: "Mergers Emerge as Dominant Trend," July 2013, page 52

Other JofA articles

- "Succession Planning: The Challenge of What's Next," Jan. 2013, page 44
- "Planning and Paying for Partner Retirements," April 2012, page 28
- "Traps for the Unwary in CPA Firm Mergers and Acquisitions," Aug. 2011, page 36
- "Mergers & Acquisitions of CPA Firms," March 2009, page 58, and "Keeping It To-

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what a deal would look like philosophically and financially, subject to verification in due diligence.

Too many times the authors have seen firms go through extensive field due diligence that confirmed all the information shared originally was 100% accurate, only to make an offer that was not acceptable. This is an inglorious waste of time. Creating a foundation for an agreement with which both firms are comfortable justifies field due diligence. In the unlikely event a surprise emerges in due diligence, the offer can be adjusted or withdrawn since it was nonbinding to begin with.

The terms should be complete as to must-haves, deal structure, and terms.

Step six. Now is the time to perform field due diligence. Each firm should share what information and data it is seeking from the other, and appropriate nondisclosure agreements should be

signed (if not done previously).

The authors suggest breaking due diligence into three parts to keep the process moving. First, information that is easily available should be shared. Frequently, this can be done through email. Second, the parties should exchange information that needs more effort but that is still only data. Third, the parties should conduct field due diligence in each other's offices. This is not to imply all three steps can't be done at once. What's important is to not let the process stall, waiting for the last piece of information to become available.

In a subsequent installment of this series, the authors will share in great detail suggested items that should be covered in due diligence. PCPS members can also obtain guidance in Chapter 10 of the Succession Planning Resource Center available at tinyurl.com/cx2nauz (PCPS member login required). This material includes detailed guidance on due diligence and also

on the entire M&A process.

Step seven. Now that it is time to close the deal, the parties can bring in lawyers. The selling firm's partners probably have enough experience to negotiate financial terms and business plan issues on their own, or they might be using a consultant to assist. Often the best use of legal advice is to make sure the deal that is negotiated is properly memorialized in a contract and the legal i's are dotted and t's crossed.

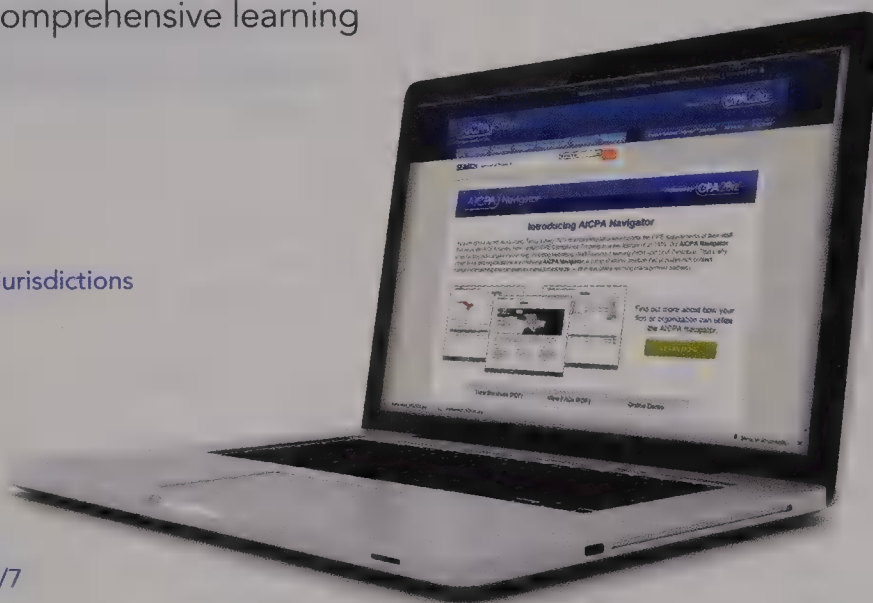
It is best to avoid renegotiating deal terms on which agreements have already been reached, and contract drafts should not be used as a tool for further negotiations of financial terms and business plan issues. If something new, other than a legal issue, needs to be addressed, it should be brought up orally. Few things irritate the other side more than a new item suddenly popping up in a contract draft. ♦

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How to Help Clients

Make the Right Social Security Election

CPAs need to start by focusing on four key aspects of the decision.

by James Sullivan, CPA/PFS

As the wave of Baby Boomer retirements continues, it is more important than ever for CPAs to understand how to help clients be in the best position to maximize Social Security benefits. Mastering the intricacies of the rules is no easy task, especially for accountants who don't concentrate full time on financial planning. Fortunately, a CPA does not have to be a Social Security expert to raise the topic with clients or answer basic questions. To help CPAs get started, this article presents a primer on what to consider when making the Social Security election.

To simplify the process, a CPA should ask the client to focus on four key aspects of the decision:

1. Which filing status yields the best benefit?
2. Are there reasons for a benefit reduction?
3. What issues affect the timing of starting the benefit?
4. Has the client carefully considered the longevity protection provided by Social Security?

Understanding these concepts allows the client to make a better informed deci-

sion regarding how to apply for and when to begin receiving Social Security. This article takes a look at each concept.

1. Filing Status

Social Security has several categories of beneficiaries. It is likely that clients are entitled to benefits in more than one category:

- Worker;
- Spouse or ex-spouse of a worker;
- Survivor of a worker (widow/widower; minor child/older disabled child; or financially dependent elderly

parent at the time of the worker's death);

- The dependent of a worker (minor child/older disabled child).

A beneficiary may fit into more than one category. For instance, he or she may have earned both his or her own worker's benefit and also be entitled to benefits as a spouse. To fit into a particular category, the beneficiary may have to meet other requirements. For example, for an ex-spouse to receive benefits, he or she must, among other requirements, have been married to the worker for at least 10 years before the divorce.

To maximize a client's benefits, a CPA may recommend that a benefit be filed for in one category and later switched to another category. For example, lifetime benefits for a couple may be maximized if a client at full retirement age (FRA) files first for his or her spousal benefit and at age 70 switches to his or her own worker benefit. The FRA is the age at which a beneficiary is entitled to his or her full benefit. For Baby Boomers, the FRA is age 66 or older (see Exhibit 1).

2. Benefit Reductions

Two rules can substantially reduce Social Security benefits. These are (1) the government pension offset (GPO) and (2) the windfall elimination provision (WEP). Only clients who have worked for, or whose spouse has worked for, *uncovered* wages are affected by these provisions. Uncovered wages are wages paid to a worker that are not covered by Social Security.

The decision of when to file should take into account the longevity protection that Social Security provides.

Examples include many state and local government jobs—such as teaching positions. While both the WEP and the GPO reduce benefits, each provision affects different types of payments depending on the individual's filing status:

- The WEP reduces the Social Security

Exhibit 1 Determining Full Retirement Age

Year of Birth*	Full Retirement Age (FRA)
1943–1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

*If a beneficiary was born on Jan. 1 of any year, he or she should refer to the previous year.

Source: ssa.gov/retire2/retirechart.htm.

worker's benefit paid to an individual with uncovered wages. Additional information on the WEP and an online calculator are available at tinyurl.com/7dbjze8.

- The GPO reduces (and in some cases, eliminates) any Social Security spousal or survivor benefit of a spouse who earned uncovered wages. If the GPO applies, the Social Security spousal or survivor payment must be reduced by two-thirds of the government pension. Additional information on the

provided prior to claiming benefits do not state whether the benefit paid will be reduced by the GPO or the WEP.

Accountants can refer to SSA Publication No. 05-10007, *Government Pension Offset*, for additional information on the GPO. Additional information on the WEP is available in SSA Publication No. 05-10045, *Windfall Elimination Provision*. Both are available at socialsecurity.gov.

3. Timing

Social Security provides eligible individuals flexibility regarding the timing of receiving their benefits. The worker's benefit may begin as early as age 62, as late as age 70, or any time in between. The participant's full benefit is determined as of his or her FRA. This full benefit is also known as the participant's primary insurance amount (PIA). The PIA is used to calculate the reduction for the worker taking his or her benefit early and to calculate the increase if the worker decides to delay his or her benefit until after FRA. The PIA is also used to calculate a spousal benefit.

If a benefit is filed before reaching FRA, the PIA may be decreased by as much as

30%. This represents an actuarial reduction of the full benefit that would otherwise be paid at FRA. The actuarial reduction recognizes that if the participant files for an early benefit at any time before FRA, he or she will be receiving a monthly payment for a longer time than if the participant waited until FRA. To make up the difference, each check is reduced. The reduction is permanent, although annual inflation adjustments will still be made.

If a benefit is filed for at FRA, the worker is paid his or her full benefit. If a benefit is filed for after FRA up to age 70, the monthly payment could increase by as much as 32% due to the application of delayed retirement credits (DRCs). DRCs increase the monthly benefit by 8% for every year of delay between FRA and age 70. DRCs stop after age 70. This increase recognizes that if the worker delays receipt of his or her benefit until after FRA, fewer checks will be received over the recipient's lifetime. To offset this, each check is increased by the DRCs.

There are, of course, good reasons not to delay Social Security payments. For example, if a client is chronically ill and expects to die relatively young, filing for benefits at age 62 makes sense. An early start also may be necessary if the client has no other financial resources and cannot afford to delay.

As a general rule, it is better for a client to delay taking Social Security benefits for as long as possible to maximize lifetime benefits. For planning purposes, the decision of when to file should take into account one final factor that is often over-

looked—the longevity protection that Social Security provides.

4. Longevity Protection

Because people rarely know exactly how long they will live, there is always a possibility that a client will outlive his or her retirement savings. Planners use longevity protection strategies to safeguard against this. The goal is to prevent clients from running out of retirement savings or to help them receive the largest Social Security benefit possible if that happens.

Social Security is an annuity that a client can't outlive. The client can maximize the size of that annuity by delaying

the second to die is a key factor that is often overlooked.

Many advisers rely on a simple break-even analysis as the only factor in making the timing decision. As previously mentioned, a client receives more lifetime checks but a reduced benefit if the Social Security benefit is elected early. A delay means fewer lifetime checks but larger monthly payments.

The break-even analysis compares the lower payment received each month if an early election is made with the larger payment received if the election is delayed. For example, assume the client can elect a benefit at age 62 that is \$750 per month

With proper Social Security planning,
a CPA can put the client in the best position
to maximize benefits.

taking the larger monthly benefit until age 70. While it requires patience on the client's part, there are long-term benefits. Delaying means that clients and their surviving spouse, if any, will receive larger Social Security benefit payments, which will help if they exhaust their retirement savings. Those larger checks also can help offset the increased health care and custodial costs often associated with old age.

Longevity protection is important whether a participant is single or married. If a client is single, only the participant's life expectancy is a concern. If a client is married, however, the life expectancy of

or wait until age 70 to receive \$1,320 per month. In this simplified example, if the client lives to age 80 or longer, he or she will be better off delaying taking a benefit to age 70. That's because at age 80 the cumulative benefits paid under each election will be approximately equal. Living beyond age 80 will result in more cumulative benefits being paid under the delay strategy. If the client expects to die before age 80, taking a benefit early is the better strategy.

The break-even analysis fails, however, to take into account Social Security's longevity protection. This protection is very valu-

EXECUTIVE SUMMARY

■ **The current and pending wave of retirements of the Baby Boomer generation** makes it more important than ever for CPAs to understand how to help clients maximize Social Security benefits. To get started, advisers should concentrate on four key aspects of when clients should begin receiving benefits.

■ **Social Security has several**

categories of beneficiaries. Advisers need to determine which filing status yields the best benefit for clients.

■ **Two rules can substantially reduce Social Security benefits:** the government pension offset and the windfall elimination provision.

■ **Social Security provides eligible individuals flexibility**

regarding the timing of receiving their benefits. The worker's benefit may begin as early as age 62, as late as age 70, or any time in between.

■ **Because people rarely know exactly how long they will live,** it is always possible that a client will live long enough to exhaust his or her retirement savings. Planners need to use longevity

protection strategies to safeguard against this.

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able and should not be overlooked.

The issue of early election versus delay is especially important to the surviving spouse. Many surviving spouses step into the larger benefit being paid to the deceased spouse at his or her death. At the same time, however, the survivor loses the lower Social Security benefit he or she had been receiving prior to the spouse's death. Delaying Social Security allows the survivor to step into a larger benefit.

INTERACTION

Planning for a married couple has to be done carefully. Either spouse's election regarding his or her own worker's benefit can limit the planning alternatives. The most obvious example is an early election by the higher-earning spouse to take her worker's benefit. That may affect her husband's income if he survives her.

In some cases, it may make sense for the higher-earning spouse to file for spousal benefits. In the typical scenario, the lower-earning spouse files for spousal benefits. In the case of the higher-earning spouse, electing spousal benefits at FRA allows his or her worker benefit to increase due to DRCs. In the meantime, the spousal benefits will make up some of the loss in income from FRA to age 70. In this case, if the lower-earning spouse files for spousal benefits first, the higher-earning spouse is precluded from also filing for spousal benefits. Both spouses cannot receive spousal benefits at the same time. Social Security decisions must be made as a couple to properly coordinate benefits and successfully implement the plan.

Because planning to maximize lifetime Social Security benefits depends on how long the client will live, it is, at best, an educated guess. With proper Social Security planning, a CPA can put the client in the best position to maximize benefits. By focusing the client's attention and understanding on the four key factors, a planner can move the client from an initial inclination to take benefits early and position him or her to receive much greater value from Social Security over a lifetime. ♦

AICPA RESOURCES

JofA articles

- "PFP Q&A: Planning for Change," July 2013, page 36
- "Social Security for Two," Jan. 2009, page 30
- "Social Security: What's the Magic Age?" July 2006, page 28

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Publication

- *The Adviser's Guide to Social Security: Unlocking the Mystery of Retirement Planning*, Second Edition (#PPF1303P, paperback; and #PPF1303E, ebook)

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- 2013 Hot Tax Topics: Get Up to Speed on the Hottest Tax Topics (#733137)
- Social Security and Medicare: Advanced Analysis of the Tactics, Taxes, and the Truth (#745275)

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- *The CPA's Guide to Social Security Planning*, tinyurl.com/l856wlr
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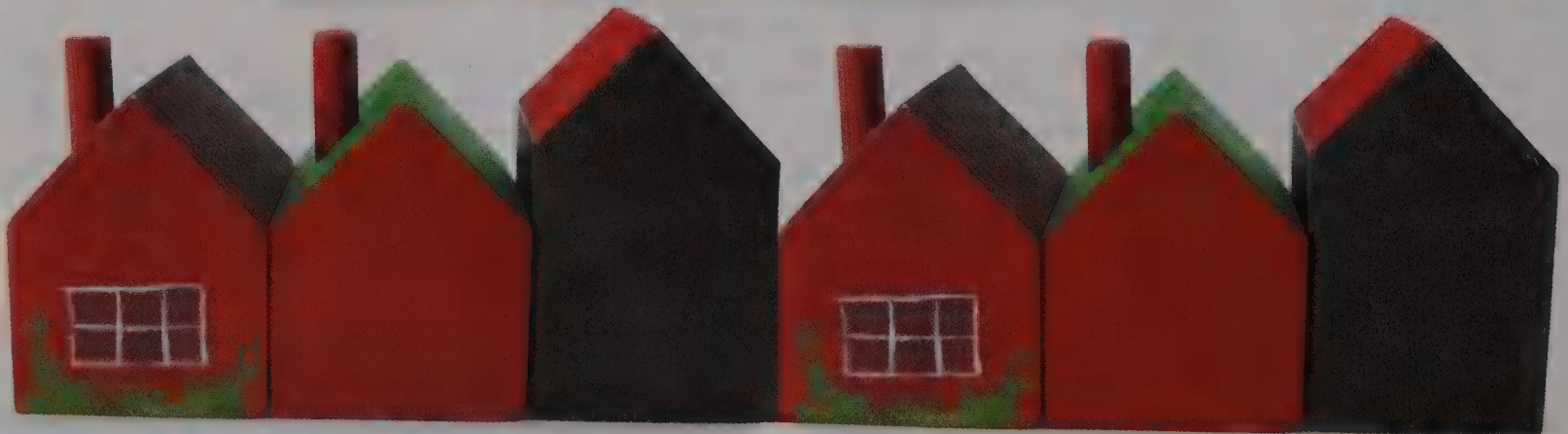
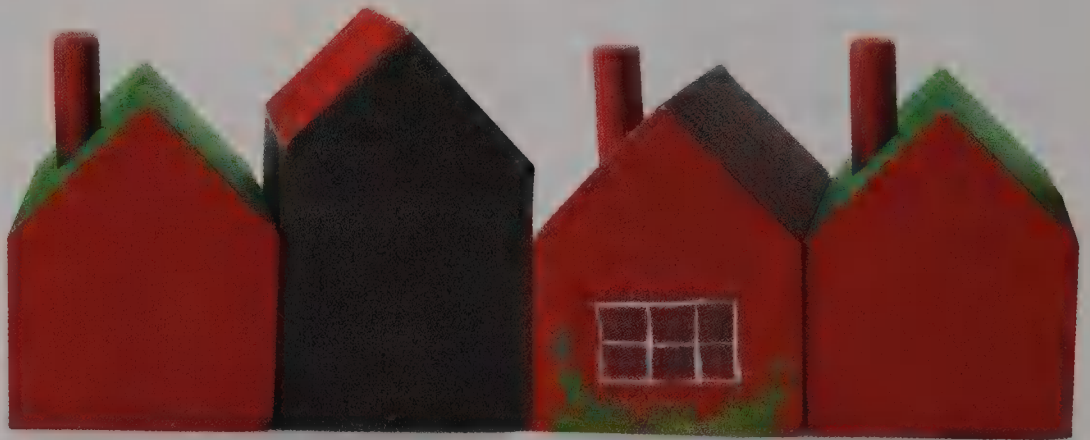
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Higher Stakes for Tax Treatment of Rental Real Estate

Help clients manage both the new net investment income tax and passive loss limitations.

by Philip Garrett Panitz, Esq.,
and Barbara Lubin, Esq.



The Health Care and Education Reconciliation Act of 2010 (Reconciliation Act), P.L. 111-152, imposes an additional 3.8% tax on net investment income, which includes income from common financial investments and from passive trade or business activities, including real estate rentals.

Starting in 2013, this tax raises the stakes for taxpayers pursuing real estate activities, particularly rentals. It increases potential financial downsides to pursuing passive activities or activities that the IRS may deem passive under Sec. 469. If the passive activity operates at a net loss for the year, the losses in excess of income are generally not currently deductible (deferred), and if the activity operates at a net gain, the profit can be hit with the additional 3.8% tax. Consequently, meeting the tests for qualifying as a real estate professional and material participation can be doubly important.

Under Sec. 1411, enacted by the Reconciliation Act, the threshold modified adjusted gross income (MAGI) amount for the 3.8% tax to apply is \$250,000 for a joint return or surviving spouse, \$125,000 for a married individual filing separately, and \$200,000 in any other case. MAGI is adjusted gross income increased by foreign earned income excluded under Sec. 911(a), which is defined as net of the deductions and exclusions disallowed with respect to the foreign earned income.

Net investment income is the sum of the excess of:

- Gross income from interest, dividends, annuities, royalties, and rents, other than such income that is derived in the ordinary course of a trade or business that is not a passive activity or a trade or business of trading in financial instruments or commodities;
- Other gross income derived from a trade or business that is a passive activity with respect to the taxpayer or a trade or business of trading in financial instruments or commodities; and
- Net gain (taken into account in computing taxable income) attributable to the disposition of property other than property held in a trade or business that

is not a passive activity or a trade or business of trading in financial instruments or commodities; over

- Allowable deductions allocable to such gross income or net gain (Sec. 1411(c)(1)).

Passive activities under Sec. 469 generating net investment income include, notably, real estate rental activities, except for real estate rental activities of materially participating real estate professionals, as described below. Therefore, it is now all the more important for taxpayers who meet the threshold amount who are real estate professionals to be able to document and support their material participation in real estate activity, not only to preserve their ability to recognize losses from the activity but also to limit their net investment income tax liability.

PASSIVE ACTIVITY LOSSES

Under Sec. 469(a), a passive activity loss of an individual for a tax year is generally not allowed as a deduction for the year. For this purpose, the passive activity loss is generally the amount by which the passive activity deductions for the tax year exceed the passive activity gross income for the year (Sec. 469(d)(1) and Temp. Regs. Sec. 1.469-2T(b)(1)). Sec. 469(c) defines "passive activity" as any activity that involves the conduct of any trade or business in which the taxpayer does not materially participate and any rental activity without regard to whether the taxpayer materially participates in the activity (but see discussion of material participation by a real estate professional, below).

Generally, disallowed passive losses may be carried forward to the next tax year (Sec. 469(b)). However, if the activity continues to be passive in future years, losses are in effect carried forward until the underlying activity is disposed of (Sec.

469(g)). In the real world, this translates to the losses accumulating until the property is sold.

RENTAL REAL ESTATE ACTIVITIES

Although rental real estate activities are *per se* passive, they may nonetheless avoid the passive loss limitations if the taxpayer (1) qualifies as a real estate professional and (2) materially participates in each rental activity. Under Sec. 469(c)(7)(B), a taxpayer is a real estate professional if (1) more than one-half of the personal services the taxpayer performs in trades or businesses during the tax year are performed in real property trades or businesses in which the taxpayer materially participates, and (2) the taxpayer performs more than 750 hours of services during the tax year in real property trades or businesses in which the taxpayer materially participates. In a joint return, these requirements are satisfied if either spouse separately satisfies them (Sec. 469(c)(7)(B)).

The best way to explain and simplify this complicated Code section is to visualize two circles, one large and one small (see Exhibit 1). The smaller circle is completely within the larger circle. The larger circle represents all the taxpayer's activity relating to the real estate profession. All activities (hours) that are spent on real estate that fall within the larger circle count toward the two tests mentioned above, both toward the 750 hours on real-estate-related activities and toward the more-than-50% test; in other words, the taxpayer must spend more time on real-estate-related activities than on non-

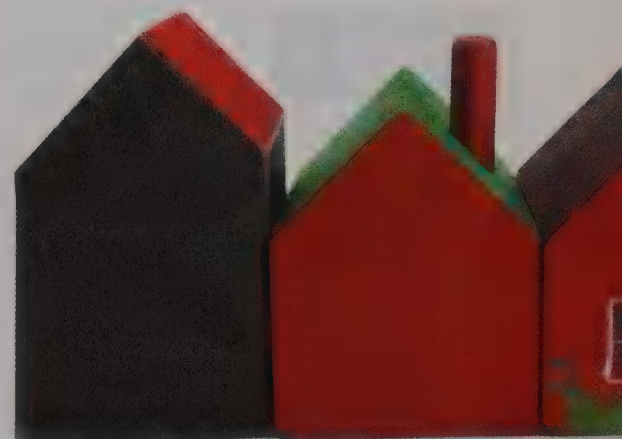
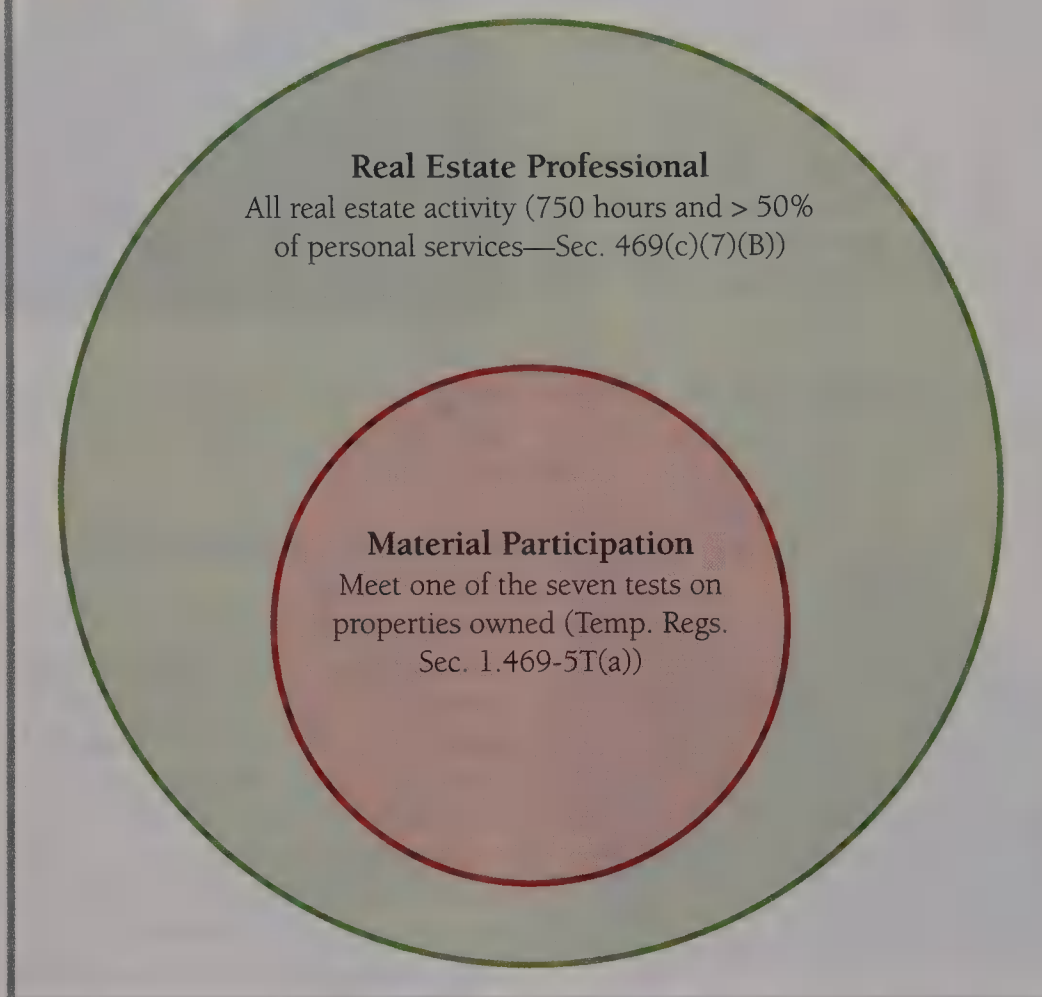


Exhibit 1

Two-Part Test for Qualifying as a Real Estate Professional



real-estate-related activities.

The second, smaller circle represents material participation hours on particular properties owned by the taxpayer. As

explained later, the tests for material participation relating to the properties owned (since they fall within both the smaller circle and the larger one) count

toward the “real estate professional tests,” above, as well. The hours spent on particular properties also count toward the specific property-by-property material participation tests.

However, activities relating to real estate in general (in the larger circle but not in the smaller one) do not count toward the specific property material participation tests and only count toward the real estate professional tests. An example would be a taxpayer who is searching for additional replacement property to acquire in a Sec. 1031 exchange. The taxpayer is certainly engaged in a real-estate-related activity, and his or her hours in this regard count toward being a real estate professional. But, because no property is actually owned related to the activity, no material participation hours are acquired relating to a specific activity, as explained in greater detail below.

QUALIFYING AS A REAL ESTATE PROFESSIONAL More Than One-Half of Personal Services in Real Property Trades or Businesses

As a practical matter, it is exceedingly difficult for taxpayers to prove to the IRS’s satisfaction that they meet the real estate professional threshold if they are otherwise employed in an unrelated occupation.

The IRS typically uses this first factor (the bigger circle) to exclude taxpayers

EXECUTIVE SUMMARY

■ **Beginning this year, taxpayers with income or loss from passive rental real estate activities** face twin perils. Besides the passive loss limitation of Sec. 469 as in previous years, high-income taxpayers may now be subject to the new 3.8% net investment income tax on such income.

■ **Taxpayers may be able to avoid either hazard** if they can establish that they materially participate as real estate profes-

sionals in their real estate activities. A qualifying real estate professional must perform more than one-half of all personal services in real property trades or businesses in which the taxpayer materially participates. These real property activities must also total more than 750 hours during the tax year.

■ **Taxpayers must also show they materially participated in rental real estate activities by each property separately or**

grouped, if they elect to treat them all as a single activity. Material participation must be established under at least one of seven tests under Temp. Regs. Sec. 1.469-5T(a).

■ **Contemporaneous logs describing activities** and recording hours spent on them, while not required, are strongly encouraged as a practical means of substantiating material participation, along with other supporting substantiating documents.

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with non-real-property-related full-time occupations. An examiner assumes that 40- or 50-hour-a-week wage earners would have to spend more than an additional 40- or 50-plus hours a week in a real property trade or business. Even if the taxpayer does not work full time in an unrelated occupation, an unrelated part-time occupation can still make it difficult for him or her to meet the 50% requirement.

More Than 750 Hours Spent in a Real Property Trade or Business

The second requirement of proving more than 750 hours were spent in the tax year materially participating in real property trades or businesses likewise presents a substantial issue of proof. In *DeGuzman*, 147 F. Supp. 2d 274 (D.N.J. 2001), the taxpayer husband failed to meet the 750-hour requirement when a portion of the hours were spent cleaning, shoveling snow, and maintaining his wife's leased office space, because he was basically just being a nice husband rather than participating in a trade or business. Hours spent on call, available to attend to rentals should the need arise, do not count toward the 750-hour requirement (see *Moss*, 135 T.C. 365 (2010)).

Furthermore, without a detailed, contemporaneous log, the Tax Court has repeatedly found reconstructed logs and taxpayer testimony to be inadequate proof of the number of hours (see, e.g., *Harnett*, T.C. Memo. 2011-191). The Treasury regulations do not specifically require a contemporaneous log and indicate that a "narrative summary" by the taxpayer can suffice (Temp. Regs. Sec. 1.469-5T(f)). In

practical application, however, the IRS regularly dismisses a narrative summary as self-serving and is more apt to accept a contemporaneously created log that is cross-referenced to objective substantiation.

A good example of an acceptable log is one that references, for example, "meetings with the plumber," and the hours indicated are cross-referenced to a calendar entry, an invoice from the plumber with that date, and telephone records of calls made to the plumber's number.

MATERIAL PARTICIPATION

If the two threshold real estate professional factors are satisfied, each rental activity will nonetheless be treated as a passive activity under Sec. 469(c)(1), unless the taxpayer materially participated in each rental activity (evaluated separately) (Regs. Sec. 1.469-9(e)(1)), unless the taxpayer elects to treat all interests in rental real estate as a single rental real estate activity. The hours spent on material participation on specific properties is the theoretical "smaller circle" mentioned above. Every hour spent by the taxpayer that counts toward material participation with respect to the actual properties owned by the taxpayer also counts toward the hours required to be a qualified real estate professional (as they fall within both circles).

In other words, in determining a taxpayer's material participation in a rental real estate activity, the rental real estate activity cannot be grouped with any other activity of the taxpayer (Regs. Sec. 1.469-9(e)(3)(i)). For instance, a taxpayer's activities as a real estate agent assisting clients

with buying and selling homes and maintaining bank-owned properties are separate from his or her activity as the owner of rental real estate for the purpose of determining whether he or she passes the material participation tests with respect to the rental real estate (see *Hoskins*, T.C. Memo. 2013-36). Likewise, in *Perez*, T.C. Memo. 2010-232, the taxpayer qualified as a real estate professional, but she did not actively participate with regard to her three rentals. Her activity as a real estate agent and loan broker was separate and irrelevant to whether she materially participated in the "smaller circle" of the rental real estate activities.

A taxpayer can establish material participation by satisfying any one of seven tests provided in Temp. Regs. Sec. 1.469-5T(a): (1) The individual participates in the activity for more than 500 hours during such year; (2) the individual's participation in the activity for the tax year constitutes substantially all of the participation in such activity of all individuals (including individuals who are not owners of interests in the activity) for the year; (3) the individual participates in the activity for more than 100 hours during the tax year, and that individual's participation in the activity for the tax year is not less than the participation in the activity of any other individual (including individuals who are not owners in the activity) for the year; (4) participation in the activity is significant (exceeds 100 hours during the year), and the individual's aggregate participation in all significant participation activities during



the year exceeds 500 hours; (5) the individual materially participated in the activity for any five tax years (whether or not consecutive) during the immediately preceding 10 tax years; (6) the activity is a personal service activity (performing personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or any other trade or business in which capital is not a material income-producing factor), and the individual materially participated in the activity for any three tax years (whether or not consecutive) preceding the tax year; or (7) based on all the facts and circumstances (including specified ones in Temp. Regs. Sec. 1.469-5T(b)), the individual participated in the activity on a regular, continuous, and substantial basis during the year.

Work done by an individual in the capacity of an investor in an activity is not generally treated as participation in the activity (Temp. Regs. Sec. 1.469-5T(f)(2)(ii)(A)). The IRS typically considers activities of an investor for this purpose to include studying and reviewing financial statements or reports on operations of the activity, preparing or compiling summaries or analyses of the finances or operations of the activity for the individual's own use, and monitoring the finances or operations of the activity in a nonmanagerial capacity (Temp. Regs. Sec. 1.469-5T(f)(2)(ii)(B)). In *Lapid*, T.C. Memo. 2004-222, the Tax Court found that reviewing financial statements and reports on operations from a management company was time spent in the taxpayer's capacity as an investor, and thus they did not count toward material participation hours.

In addition, work is not treated as material participation if it is not of a type customarily done by an owner of such activity and if one of the principal purposes for performing such work is to avoid the passive activity limitations of Sec. 469. If the taxpayer uses the services of a management company and the taxpayer's only activity is reading reports from the management company, that is an investor type of activity and is therefore

Work done by an individual in the capacity of an investor in an activity is not generally treated as participation in the activity.

passive. On the other hand, if the taxpayer is managing the property himself or herself and generating the reports for an accountant to put on a tax return, this should more likely count toward material participation.

To prove material participation, taxpayers face an uphill battle when their rental real estate activity is out of state or when a management company is involved. In *Madler*, T.C. Memo. 1998-112, the Tax Court found that the taxpayers failed to show that they, rather than the third-party management company they hired, materially participated in their real property rental activity. See also *Koenig*, T.C. Memo. 1998-215, finding real estate losses were passive when the taxpayer managed one rental property but hired a management company for four other rental properties.

When rental real estate is out of state, the IRS highly scrutinizes claims of material participation because it appears unrealistic to an examiner that taxpayers can do much on a property 2,000 miles from their home, for instance. In a rare taxpayer victory involving both of these issues, taxpayers were able to deduct the losses from one of their two out-of-state Hawaiian condos, without the passive loss limitations (*Pohoski*, T.C. Memo. 1998-17).

The key to overcoming the IRS's bias against out-of-state property owners is to thoroughly document the tasks performed

on the properties managed, with as much objective and as little subjective documentation as possible. A New York taxpayer managing her Florida rentals spent most of her working hours on the telephone with contractors, tenants, accountants, etc., and was able to convince the IRS that she was managing her properties from her base in New York. This was documented with telephone records, affidavits from the vendors, travel records,

invoices, and substantiation notebooks, to the point that the IRS capitulated in the matter before trial (*Hendren*, No. 28245-07 (Tax Ct., settlement entered 3/2/11)).

ELECTION TO TREAT ALL REAL ESTATE INTERESTS AS A SINGLE ACTIVITY

As mentioned above, once a taxpayer qualifies as a real estate professional, his or her material participation is determined separately with respect to each rental property unless he or she elects to treat all interests in rental real estate as a single rental real estate activity (Sec. 469(c)(7)(A); Regs. Secs. 1.469-9(e)(1) and 1.469-9(g); see also *Bailey*, T.C. Memo. 2001-296). To make this election, the taxpayer files a statement with his or her original income tax return (see Regs. Sec. 1.469-9(g)(3)).

Once the election is made, it is binding for the tax year in which it is made and, unless duly revoked by the taxpayer, for all future years in which the taxpayer is a real estate professional, even if there are intervening years in which he or she is not a real estate professional. If a taxpayer failed to file an election to treat all interests in rental real estate as a single rental real estate activity with the original income tax return, Rev. Proc. 2011-34 allows the late filing of an election with an amended income tax return, provided several criteria are satisfied.



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DISTINGUISHING RENTAL REAL ESTATE ACTIVITIES

In evaluating material participation, it is important to distinguish the properties that qualify as rental real estate from those that do not. In other words, if an election to treat "all as one" is made, only those hours spent with regard to properties that properly qualify as rental real estate count toward the annual hours of material participation requirements (Temp. Regs. Sec. 1.469-1T(e)(3); see also *Hoskins*, T.C. Memo. 2013-36, and *Bailey*, T.C. Memo. 2001-296).

Residential rental property that is rented, on average, for seven days or less at a time is not considered a rental activity for purposes of Sec. 469(c) ("vacation rentals") (see Temp. Regs. Sec. 1.469-1T(e)(3) and *Lapid*, T.C. Memo. 2004-222). With vacation rentals excluded from rental activities within the meaning of Sec. 469(c), the real estate professional test is not a prerequisite, but material participation is still required to avoid the passive loss rules (see *Chapin*, T.C. Memo. 1996-56 (finding that the taxpayers did not materially participate when they had rental agents to handle the day-to-day operations); also *Mordkin*, T.C. Memo. 1996-187).

RECOMMENDATIONS FOR WITHSTANDING IRS SCRUTINY

The general rule is that taxpayers must substantiate amounts claimed as deductions by maintaining the records necessary to establish that they are entitled to the deduction (Sec. 6001; Regs. Sec. 1.6001-1(a)). With respect to the evidence that may be used to establish hours of participation, Temp. Regs. Sec. 1.469-5T(f)(4) provides:

The extent of an individual's participation in an activity may be established by any reasonable means. Contemporaneous daily time reports, logs, or similar documents are not required if the extent of such participation may be established by other reasonable means. Reasonable means for purposes of this paragraph may include but are not lim-

ited to the identification of services performed over a period of time and the approximate number of hours spent performing such services during such period, based on appointment books, calendars, or narrative summaries.

As a practical matter, the best advice a tax professional can give a client who is claiming to be a real estate professional and/or claiming material participation is to strongly encourage the client to maintain a contemporaneous log detailing hours spent and describing the services provided. The Tax Court clearly discounts evidence based merely on testimony, memory, and logs reconstructed after the fact:

This Court has previously noted that while the regulations are somewhat ambiguous concerning the records to be maintained by taxpayers, we are not required to accept a postevent "ballpark guesstimate," or the unverified, undocumented testimony of taxpayers. [*Hoskins*, T.C. Memo. 2013-36]

See also *Lee*, T.C. Memo. 2006-193, finding the taxpayers' post-event time logs and trial testimony were exaggerated and "not really in the ballpark at all" when they claimed to have spent more than half of their time on rental real estate activities but were otherwise employed in unrelated full-time occupations, and *D'Avanzo*, 67 Fed. Cl. 39 (Fed. Cl. 2005), aff'd 215 Fed. Appx. 996 (Fed. Cir. 2007).

Submitting time logs at trial with significantly more hours than were submitted at audit has proved to be a poor strategy as well (see, for example, *Lee*, T.C. Memo. 2006-193, and *Anyika*, T.C. Memo. 2011-69). In both cases, the taxpayers apparently considered only the 750-hour requirement of the real estate professional test and then, at trial, learned of the equally important more-than-50% requirement. If taxpayers' rental real estate activity is located far from their personal residence or a management company is involved in the rental, a contemporaneous, detailed log is even more important because, as discussed above, those situations will almost surely be subject to scrutiny in an IRS audit.

EVEN GREATER CONSEQUENCES

The taxation of rental real estate and passive losses is a battle that now holds even greater consequences with the 3.8% additional tax. This area of law was always complicated, but with good tax planning, it is one that can withstand an IRS audit. ♦

AICPA RESOURCES

JofA article

- "Real Tax Savings in Real Estate," Feb. 2008, page 68

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The Tax Adviser articles

- "Planning for the 'Parallel Universe' of the Net Investment Income Tax," Aug. 2013, page 534
- "3.8% of What? An Overview of the Net Investment Income Tax," April 2013, page 257

To find articles from *The Tax Adviser*, go to thetaxadviser.com and search by year in the left-hand column.

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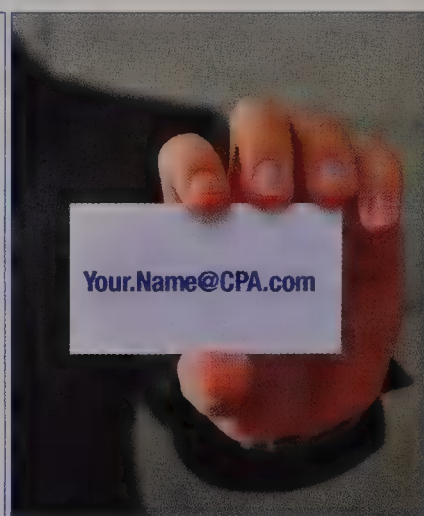
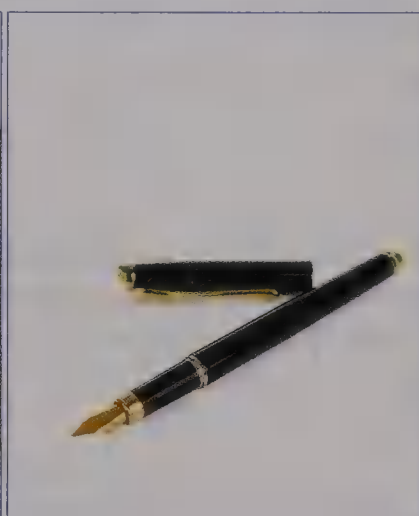
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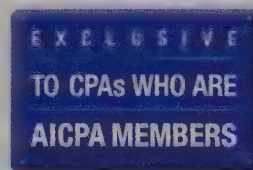


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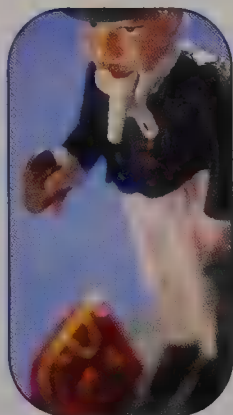
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TAX PRACTICE CORNER

IRS Oversight of CPAs Who Provide Valuation Services

Under Sec. 6695A, enacted by the Pension Protection Act of 2006, P.L. 109-280, appraisers may face monetary penalties for appraisals that lead to substantial and gross valuation misstatements on returns.

This section is intended to provide greater assurance that all appraisers and appraisals meet a minimum threshold of qualification. These qualifications include those of Secs. 170(f)(11)(E)(ii) and (iii), which provide that a qualified appraiser is an individual who:

- Has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements in IRS regulations;
- Regularly performs appraisals for which the individual receives compensation;
- Meets other requirements of IRS regulations or other guidance;
- With respect to any specific appraisal, demonstrates verifiable education and experience in valuing the type of property subject to the appraisal and has not been prohibited from practicing before the IRS at any time during the three-year period ending on the date of the appraisal.

Sec. 170(f)(11)(E)(i) defines a qualified appraisal as one that is (1) treated as a qualified appraisal under regulations or other IRS guidance and (2) conducted by a qualified appraiser "in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed" by the IRS. The IRS provided guidance on these terms in Notice 2006-96 and Prop. Regs. Sec. 1.170A-17.

The AICPA finalized and issued Statement on Standards for

Valuation Services No. 1 (SSVS1), *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset*, soon after the enactment of Sec. 6695A. SSVS1 applies to all AICPA members, whether or not they hold an Accredited in Business Valuation (ABV) credential, and allows the AICPA to be recognized by the IRS as having generally accepted business appraisal standards, along with other organizations including the American Society of Appraisers, the National Association of Certified Valuators and Analysts, and the Institute of Business Appraisers.

The Sec. 6695A review process has a three-year statute of limitation from the later of the return's due date or filing date. This process is independent of any tax deficiency negotiations with the taxpayer or any litigation. If an IRS reviewer believes that the correct value of the interest being appraised differs from the appraised value and that the appraiser has not complied with his or her organization's standards, the review process may lead to penalties under Sec. 6695A and a possible referral to the Office of Professional Responsibility (OPR), which is charged with ensuring that practitioners adhere to professional standards and follow the law.

The penalty determination under Sec. 6695A asks two questions: First, is there a substantial or gross valuation misstatement, i.e., is the reported value for the property equal to or greater than 150% (substantial) or 200% (gross) of the correct value? Or, in the case of an estate or gift tax return, is the reported value equal to or less than 65% (substantial) or 40% (gross) of the correct value? If so, then the IRS asks: Is there a greater than 50% likelihood that the appraiser will prevail in court?

The penalty on a CPA or other person who provides a substantial or gross valuation misstatement is the lesser of:

1. The greater of \$1,000 or 10% of the underpayment attributable to the misstatement, or
2. 125% of the gross income received from preparation of the appraisal.

If there was no direct appraisal fee, the IRS looks to other indications of compensation.

While penalties can be substantial, the appraiser may be more concerned about referral to the OPR and potential

ramifications for non-IRS-related work, such as being excluded as an expert witness. A CPA whose valuation opinion or

A CPA firm may want to establish that only its members with ABV or comparable credentials do business valuations or offer opinions about value.

advice resulted in a penalty also could have professional liability implications for the firm and ethics compliance implications with the AICPA and the relevant state's board of accountancy.

The OPR applies Treasury Circular 230, *Regulations Governing Practice Before the Internal Revenue Service* (31 C.F.R. Part 10). Its

August 2011 revision (T.D. 9527) added specific language related to appraisers. Potential sanctions include

censure, suspension, and disqualifying individuals from practice before the IRS. Penalties may be imposed against the individual and the individual's firm. All CPAs providing valuation opinions should be aware that this is an area of increased IRS scrutiny.

Practice tip. A CPA firm may want to establish that only its members with ABV or comparable credentials do business valuations or offer opinions about value. Partners should not offer clients oral or back-of-the-envelope valuation advice or preliminary analysis. CPAs need to understand SSVS1 and the potential ramifications to the individual and to the firm. Any practitioner doing a valuation who does not follow his or her credentialing organization's standards poses a real danger to the individual and the firm. CPAs should also have

a clear understanding with clients of the scope of engagements that could involve valuation issues. This is

good for the CPA, the client, and the profession. ♦

Editor's note: This column is abridged and adapted from the authors' article of the

same title in *The Tax Adviser*, Nov. 2013, page 762.

By **Michael Gregory**, ASA, CVA (mg@mikegreg.com), founder of Michael Gregory Consulting LLC in Roseville, Minn., and **Renée Marino**, CPA/ABV, CFA, ASA (renee@cupitorconsulting.com), a business appraiser and expert witness with Cupitor Consulting LLC in Arden Hills, Minn. Gregory is a former IRS territory manager who focused on business valuation issues. Marino is a member of the board of governors for the American Society of Appraisers.

To comment on this article or to suggest an idea for another article, contact Paul Bonner, senior editor, at pbonner@aicpa.org or 919-402-4434.

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MARITAL STATUS

IRS ISSUES EMPLOYMENT TAX REFUND PROCEDURES FOR SAME-SEX SPOUSES

In Notice 2013-61, the IRS announced the procedures employers should follow for filing refund claims for overpaid Federal Insurance Contributions Act (FICA) and income taxes paid on employer-provided benefits for same-sex spouses that, because of the Supreme Court's *Windsor* decision, are now tax free. The notice provides two streamlined administrative procedures for making adjustments or claiming refunds.

Windsor, No. 12-307 (U.S. 6/26/13), overturned the portion of the Defense of Marriage Act that had prohibited federal recognition of same-sex marriages. In August, the IRS issued Rev. Rul. 2013-17, explaining how it would treat same-sex married couples for tax purposes after *Windsor* (see "Tax Matters: All Legal Same-Sex Marriages Recognized for Tax Purposes," Nov. 2013, page 56).

Notice 2013-61 contains streamlined procedures for employers who wish to file refund claims for payroll taxes paid on previously taxed health insurance and fringe benefits provided to same-sex spouses. If an employer withheld employment taxes for same-sex spouse benefits paid to or on behalf of an employee in the third quarter of 2013 and repaid or reimbursed the employee for these amounts before filing Form 941, *Employer's Quarterly Federal Tax Return*, for the third quarter of 2013 (normally due Oct. 31), the employer should not have reported these wages and withholding on that form. If the employer did not repay or reimburse the employee for the overcollected amount before it filed the third quarter 2013 Form 941, the employer

must have reported the overcollected amount on that return and can use one of two special administrative procedures to make an adjustment or claim a refund.

First refund or adjustment method. Under the first alternative method, the employer must repay or reimburse employees for the amount of the overcollected FICA and income tax withholding for the same-sex spouse benefits for the first three quarters of 2013 on or before Dec. 31, 2013, and then, on its fourth quarter 2013 Form 941, it may reduce the fourth-quarter wages, tips, and other compensation on line 2; taxable Social Security wages on line 5a (subject to the wage base limitation for the year); and taxable Medicare wages and tips on line 5c, all by the amount of the same-sex spouse benefits treated as wages for the first three quarters of 2013.

The income tax withheld from wages, tips, and other compensation reported on line 3 of Form 941 should be reduced by the amount of income tax withholding that has been repaid or reimbursed to employees by the end of the calendar year. If the value of any same-sex spouse benefits was included in taxable wages subject to additional Medicare tax withholding on line 5d, this amount should also be reduced. Employers that qualify will not have to file separate Forms 941-X, *Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund*, to correct each of the first three quarters of 2013.

Second refund or adjustment method. Employers that have not reimbursed or repaid employees by Dec. 31 can file Form 941-X. If the employer has satisfied the usual requirements for filing Form 941-X, including repaying or reimbursing the overcollected employee FICA tax to employees (or, for refund claims, securing consents from employees), and obtaining the required written statements from em-

ployees, the employer can write "WINDSOR" in dark, bold letters across the top margin of page 1 of Form 941-X.

An employer may not claim a refund or credit for an overpayment of income tax withholding if the tax was deducted and withheld from the employee. This second procedure for 2013 cannot be used for income tax withheld from employees, because the employer can use this method only if it did not repay or reimburse employees for the amount of withheld taxes for same-sex spouse benefits provided in 2013 on or before Dec. 31, 2013. In these cases, employees will receive credit for the income tax withheld when they file their Form 1040, *U.S. Individual Income Tax Return*.

Notice 2013-61 also provides procedures employers should follow for overpaid FICA taxes for years before 2013 that are still open under the statute of limitation. Form 941-X must be filed, and the normal requirements that apply to correcting overpayments in earlier years must be followed, including the filing of Forms W-2c, *Corrected Wage and Tax Statement*, repaying or reimbursing employees, and obtaining the required written statements (and consents) from employees.

■ Notice 2013-61

By **Sally P. Schreiber, J.D.**, a JofA senior editor.

CAPITALIZATION OF COSTS

LONG-AWAITED REPAIR REGULATIONS ARE ISSUED

The IRS issued long-awaited final regulations (T.D. 9636) regarding the treatment of expenditures incurred in acquiring, producing, or improving tangible assets, including rules on determining whether costs related to tangible property are de-

ductible repairs or capital improvements.

The IRS noted that it had received many comments on the regulations, most of which it addressed in issuing the rules. (The AICPA submitted a comment letter recommending various changes, available at tinyurl.com/oxnm3gx.)

The regulations affect all taxpayers that acquire, produce, or improve tangible property. The final regulations, which apply to tax years beginning on or after Jan. 1, 2014, do not finalize or remove the temporary regulations governing dispositions of property under Sec. 168. Instead, to address significant changes in this area, revised proposed regulations were issued at the same time as the final regulations.

The final regulations adopt the temporary regulations issued in 2011 (T.D. 9564), with the following changes:

- In response to comments that the \$100 threshold for property that is exempt from capitalization was too low, the final rules raise it to \$200 and retain the rule that the amount can be increased in IRS guidance. The rules also incorporate the definition of standby emergency spare parts contained in Rev. Rul.

81-185 and make these spare parts eligible for the optional election to capitalize certain materials and supplies.

- The final rules retain the rule in the temporary regulations permitting taxpayers to elect to capitalize certain materials and supplies but, in response to comments, limit the rule to rotatable, temporary, or standby emergency spare parts. Rotatable parts are those acquired for installation on a unit of property that can be removed from the property and generally are repaired or restored and can be reinstalled on the same or another unit of property or stored for later installation (Regs. Sec. 1.162-3(c)(2)).
- The rules clarify that taxpayers may revoke the election discussed above by filing a ruling request, which the IRS will grant if the taxpayer establishes that it acted reasonably and in good faith and that revocation will not prejudice the government.
- The final rules change the requirement that taxpayers using the optional method for pools of rotatable spare parts use it for all pools of rotatable spare parts

used in that trade or business to permit taxpayers to not use the optional method for those pools of rotatable spare parts for which it does not use the optional method in its books and records for the trade or business.

- Also in response to many taxpayer comments, the final rules clarify the *de minimis* rules, including permitting the safe harbor to be elected each year, providing rules for taxpayers without applicable financial statements to use the method, and simplifying the complicated method for calculating the ceiling for applying the *de minimis* amount provided in the temporary regulations.
- The preamble clarifies that earlier revenue procedures treating certain property as materials and supplies are not affected by the final rules.
- Again in response to comments, the final rules allow taxpayers that are members of consolidated groups for financial statement purposes but not for federal income tax purposes to use the applicable financial statements and accounting procedures of their group to qualify for the *de minimis* safe harbor.
- The final rules change the treatment of additional costs of acquiring property subject to the safe harbor to include additional invoice costs, such as delivery fees.
- Again in response to comments, the final rules simplify the *de minimis* safe harbor by requiring all materials and supplies to be included if taxpayers elect to use the safe-harbor method.
- Another change is a clarification of the interaction of the *de minimis* rule with the rule under Sec. 263A that certain property be capitalized.
- The final rules clarify the meaning of certain terms that are used in determining contingency fees for inherently facilitative costs in acquiring property that are required to be capitalized.
- In response to comments, the final rules provide that taxpayers may deduct the removal cost when they remove a unit of property.

Top 10 Nonprofit Charitable Organizations, by Total Assets

Rank	Organization	Assets (in billions)
1	President and Fellows of Harvard College	\$43.9
2	Yale University	\$23.7
3	Stanford University	\$22.7
4	Kaiser Foundation Hospitals	\$19.6
5	Princeton University	\$16.3
6	Howard Hughes Medical Institute	\$16.0
7	Massachusetts Institute of Technology	\$12.9
8	Columbia University	\$10.3
9	Access Group Inc.	\$10.3
10	University of Pennsylvania	\$10.3

This year 2008, which includes returns on Form 990, Return of Organization Exempt From Income Tax, filed in calendar years 2009 and 2010.

Source: IRS, Bureau of Economic Analysis, and Direct Tax Foundation.
Organization 10: tinyurl.com/oxnm3gx

- A significant change for small taxpayers is that taxpayers with gross receipts of \$10 million or less can elect to deduct, for buildings that initially cost \$1 million or less, the lesser of \$10,000 or 2% of the adjusted basis of the property for repairs, etc., each year.

The IRS also issued proposed regulations on dispositions of property depreciable under the modified accelerated cost recovery system. The IRS had announced in Notice 2012-73 that it intended to revise the disposition rules that appeared in

statutory employment relationships. Thus, a payroll service company with statutory employees who worked for multiple common law employers had to apply the FICA and FUTA wage caps to the wages paid to each statutory employee by each common law employer. The court also upheld the lower court's decision barring the taxpayer's attempt to reclassify some of its employees as independent contractors.

Statutory employers, such as payroll service companies, are required to remit

company. In 2001, the IRS assessed FUTA tax and FICA tax deficiencies of approximately \$43.7 million and \$15.6 million, respectively, for tax years 1991–1996, on the basis that each production company was the employer for purposes of computing the wage caps. Cencast later litigated the issue, but the Court of Federal Claims agreed with the IRS. When the parties later engaged in settlement discussions, Cencast argued, for the first time, that some of the employees should be classified as independent contractors. After another round of litigation, the Claims Court barred as untimely Cencast's independent contractor argument. Cencast appealed both decisions.

The appellate court agreed with the IRS on both issues. Cencast argued the FICA and FUTA tax liabilities are imposed only on the entity that pays the wages. The court agreed that the statutory employer is an employer required to remit the taxes; however, it held the computation of the FICA and FUTA taxes is based on wages from employment, and it is the common law employer that provides that employment. Since the FICA and FUTA wage caps are defined as a portion of the remuneration for employment, the wages earned from the common law employer are the measure of the FICA and FUTA wage caps, according to the court. The court added that applying the wage caps as Cencast desired would make no sense, since common law employers could reduce their FUTA and FICA taxes by using companies such as Cencast, a result Congress could not have intended.

The appellate court also held Cencast's attempt to argue that some of the employees should be classified as independent contractors was untimely because Cencast could have raised the issue at multiple points over many years and failed to do so.

■ *Cencast Services LP*, No. 2012-5142 (Fed. Cir. 9/10/13), aff'g 94 Fed. Cl. 425 (2010)

By **Charles J. Reichert**, CPA, instructor of accounting, University of Minnesota–Duluth.

Statutory employers are required to remit employer FICA and FUTA taxes and employee FICA taxes even though they are not common law employers.

the temporary regulations. The proposed regulations contain those revisions, but taxpayers can continue to apply the rules in Temp. Regs. Secs. 1.168(i)-1T and 1.168(i)-8T for tax years beginning on or after Jan. 1, 2012, and before Jan. 1, 2014.

While the proposed regulations contain many of the same property disposition rules as the 2011 temporary regulations, they make changes to the rules on determining the asset disposed of and the qualifying disposition of an asset in a general asset account. They also contain new rules for partial asset dispositions.

■ T.D. 9636; REG-110732-13

By **Alistair M. Nevius**, J.D., the *JofA's* editor-in-chief, tax, and **Sally P. Schreiber**, J.D., a *JofA* senior editor.

FICA & FUTA

FICA AND FUTA CAPS REFER TO COMMON LAW EMPLOYMENT RELATIONSHIPS

The Court of Appeals for the Federal Circuit upheld a lower court decision that the wage caps for the Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) must be calculated by reference to common law employment relationships rather than

employer FICA and FUTA taxes and employee FICA taxes even though they are not common law employers. Although FICA and FUTA taxes are capped at different wage levels, both are imposed on every employer and are based on remuneration with respect to employment paid to an individual by an employer. Employment is any service provided by an employee, as defined by common law rules. In 1999, the IRS took the position in Technical Advice Memorandum 199918056 that payroll service companies should not aggregate the wages from multiple common law employers when computing the FICA and FUTA tax wage caps.

Cencast Services LP is a payroll service company for motion picture and television production companies. The production companies hire and supervise the workers; however, Cencast pays the workers, files payroll tax returns, and remits payroll taxes to the IRS for them. From 1991 to 1996, Cencast treated each employed production worker as its employee, and as a result, Cencast aggregated the annual wages paid to an employee and then applied the FICA and FUTA wage caps to each worker's total wages from all production companies rather than to the wages earned at each

WITHHOLDING

IRS BOUND TO HONOR DESIGNATION OF VOLUNTARY PAYMENT BY ONE TAXPAYER OF ANOTHER'S LIABILITY

In a reviewed opinion, the Tax Court held that the IRS must follow a corporation's designation of voluntary payments toward the income tax liabilities of its owners/employees. However, because the payments did not represent taxes withheld at the source, the IRS was allowed to levy on the assets of the owners/employees to collect applicable interest and penalties. Likewise, the corporation remained liable for interest and penalties attributable to its failure to remit taxes on a timely basis.

Sec. 3402 requires employers to withhold taxes from wages paid to employees. Sec. 31(a) provides employees with a credit against their income tax for amounts withheld at the source. Under Regs. Sec. 1.31-1(a), this credit is applied to the calendar year of the withholding without regard to whether or when the employer remits the tax. Tax of an employee is deemed to have been withheld at the source only if the employer (1) contemporaneously withholds tax in the

correct amount or (2) corrects a withholding error by making a timely and proper adjustment.

Rev. Proc. 2002-26 allows a taxpayer to designate how voluntary partial payments are applied against liabilities of tax, penalties, and interest. If a taxpayer does not make a designation, the IRS generally applies payments to tax, penalties, and interest, in that order. Likewise, the IRS generally honors designations of voluntary payments between different types of taxes, such as corporate income or employment tax obligations. When a tax is divisible, such as employment taxes that relate to specific employees and calendar quarters, case law has held that a taxpayer may designate and pay a divisible portion of the total tax obligation. Sec. 6331(i)(1) prohibits a levy against a taxpayer with respect to an unpaid divisible tax during pending legal proceedings.

James and Sharon Dixon served as officers and employees of Tryco, a temporary staffing business they founded in 1990. At first, Tryco was a great success, and the Dixons paid themselves generously. In late 1992, however, Tryco stopped filing and remitting employment taxes, and the Dixons stopped filing in-

dividual income tax returns. In 1997, the Dixons were criminally prosecuted for failure to file individual income tax returns for 1992 through 1995, and as part of a settlement that resulted in a reduced sentence, they agreed to make restitution to the IRS for its tax loss in the amount of \$61,021. In 1999, the Dixons contributed this amount to Tryco, and Tryco then submitted it to the IRS, accompanied by a cover letter indicating that the payment represented Tryco's withholding taxes to be applied to the withheld income taxes of the Dixons.

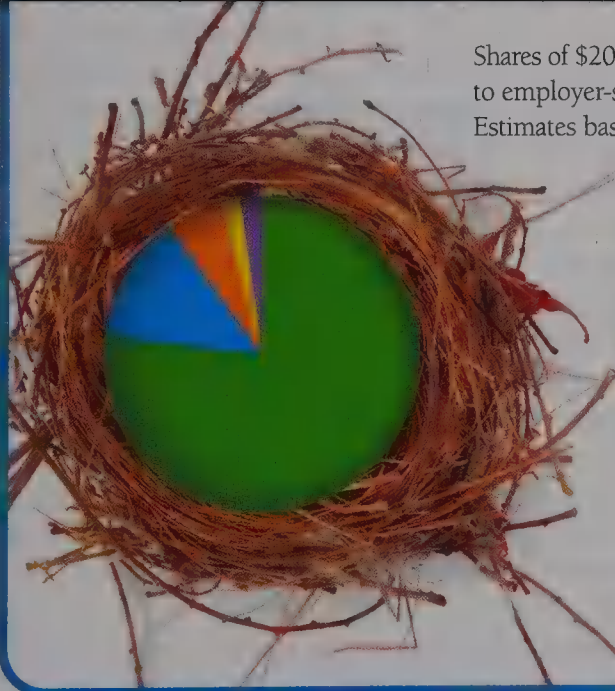
In 2000, when accountants prepared the individual income tax returns for the Dixons' missing years, they determined that the couple owed \$30,202 more in taxes than Tryco had previously submitted to the IRS. As before, the Dixons contributed this amount to Tryco, and the corporation in turn submitted it to the IRS with a cover letter indicating that the payment represented the Dixons' withheld income taxes. On the advice of legal counsel, the Dixons chose not to pay their individual income tax liabilities directly, believing that the indirect payments through Tryco would reduce both the portion of the company's withholding tax liability attributable to themselves and their own income tax liabilities. They also hoped to avoid interest and penalties on the payments by availing themselves of Sec. 31's crediting scheme, which treats withholding at the source as paid in the year of the withholding irrespective of the employer's date of remittance.

The IRS initially credited Tryco's payments to the Dixons' 1992-95 income tax liabilities, which discharged their tax obligations but not the applicable interest and penalties. Later, the IRS reversed itself and applied the payments to Tryco's general unpaid employment tax liabilities, which then exceeded \$23 million. The IRS then issued a notice to the Dixons of intent to levy on their assets in satisfaction of their now unpaid 1992-95 income tax liabilities. The Dixons petitioned the Tax Court for review.

The Dixons contended first that they

Retirement Plan Contributions, 2010

Shares of \$209.2 billion total elective contributions to employer-sponsored plans, tax year 2010. Estimates based on samples.



■	401(k)	77%
■	403(b)	13%
■	457(b)	6%
■	SIMPLE and SEP	2%
■	Roth 401(k) and 403(b)	2%

Source: Figures J and K, "Wage Income and Elective Retirement Contributions From Form W-2, 2008-2010," *Statistics of Income Bulletin*, Summer 2013, tinyurl.com/nw314gl.

were entitled to a withholding credit under Sec. 31 for the amounts submitted by Tryco on their behalf in 1999 and 2000. Second, they asserted that the IRS was obligated to honor Tryco's designation of the payments as withheld income taxes and to credit the amounts toward the Dixons' 1992-95 income tax liabilities.

The IRS argued that its policy of honoring designations of voluntary payments is confined to particular tax periods or types of tax. It contended that the policy does not extend to designations of delinquent employment tax by one party toward the income tax liability of another.

Both the majority and dissenting opinions of the court concluded that the funds submitted by Tryco to the IRS in 1999 and 2000 were not withheld at the source and, accordingly, that the Dixons were not entitled to a Sec. 31 credit against their individual income tax liabilities. Regarding the Dixons' second argument, the majority determined that the IRS was obligated to follow its published administrative position regarding designations of voluntary payments. The IRS was therefore directed to properly credit the \$91,223 payments to the Dixons' account, fully discharging their 1992-95 income tax obligations. The IRS was allowed, however, to levy on the Dixons' assets to collect applicable interest and penalties. Tryco likewise remained liable for interest and penalties.

■ *Dixon*, 141 T.C. No. 3 (2013); related decision at *Dixon*, T.C. Memo. 2013-207

By **Janet A. Meade**, CPA, Ph.D., associate professor, University of Houston.

HEALTH COVERAGE

HEALTH COVERAGE INFORMATION-REPORTING GUIDANCE ISSUED

The IRS issued two related proposed regulation projects on health care coverage reporting requirements under the Patient Protection and Affordable Care Act, P.L. 111-148. One set of proposed regulations gives guidance to providers of minimum

essential health coverage that are subject to the information-reporting requirements of Sec. 6055 (REG-132455-11). The other set gives guidance to employers subject to the information-reporting requirements of Sec. 6056 (REG-136630-12).

Sec. 6055 requires providers of minimum essential coverage and providers of coverage through an employer's group health plan to report information that

- What information is required to be reported;
- The time and manner of filing;
- Statements that must be furnished to individuals; and
- Penalties.

The regulations propose placing returns under Secs. 6055 and 6056 within the definitions of information return and payee statement under Secs. 6721 and 6722.

Treasury and the IRS say they have engaged in a dialogue with stakeholders to figure how to simplify Sec. 6055 and Sec. 6056 reporting.

will allow taxpayers to establish and the IRS to verify that the taxpayers were covered by minimum essential coverage and their months of enrollment during a calendar year.

Sec. 6056 requires applicable large employers (generally employers with 50 or more full-time employees) to report to the IRS information about the coverage that they offer to their full-time employees and requires them to furnish related statements to employees.

Treasury and the IRS asked for comments on the requirements last year and say they have engaged in a dialogue with stakeholders to figure how to simplify Sec. 6055 and Sec. 6056 reporting consistent with effective implementation of the law. The IRS delayed the effective dates for reporting under both Secs. 6055 and 6056 to 2015, although it is encouraging voluntary reporting during 2014 (Notice 2013-45).

Both sets of proposed regulations discuss the possibility of combined reporting under Secs. 6051 (requiring W-2 reporting), 6055, and 6056, but the regulation projects do not institute full combined reporting. They do discuss how to avoid duplicate reporting under the requirements for those sections.

The proposed regulations under Sec. 6055 clarify:

- Who is subject to the information-reporting requirement;

The proposed regulations under Sec. 6056:

- Define key terms;
- Discuss the responsibilities of applicable large employers with respect to full-time employees;
- Describe the content, manner, and timing of information required to be reported to the IRS and furnished to full-time employees; and
- Define the person responsible for Sec. 6056 reporting.

The preamble to the proposed Sec. 6056 regulations discusses a variety of potential simplified reporting methods that the IRS is considering. These include allowing employers to report on Form W-2, *Wage and Tax Statement*, and eliminating the need to determine full-time employees if minimum essential coverage is offered to all potentially full-time employees.

Both sets of regulations are proposed to apply for calendar years beginning after Dec. 31, 2014. Consistent with Notice 2013-45, reporting entities will not be subject to penalties for failure to comply with the Secs. 6055 and 6056 reporting requirements for coverage in 2014.

■ REG-132455-11; REG-136630-12

By **Alistair M. Nevius**, J.D., the JofA's editor-in-chief, tax.

Tax Matters editor Paul Bonner can be reached at pbonner@aicpa.org or 919-402-4434.

Line Items

IRS EXPLAINS SEC. 179 QUALIFIED REAL PROPERTY ALLOCATIONS

In Notice 2013-59 the IRS explained how the retroactive extension of the Sec. 179 rules under the American Taxpayer Relief Act of 2012, P.L. 112-240, operates when applied to qualified real property and how to allocate the portion of gain attributable to the qualified real property upon disposition or to calculate any carryover. Qualified real property includes certain leasehold improvement property, restaurant property, and retail improvement property (Sec. 179(f)(2)).

The notice states that a taxpayer may elect to apply Sec. 179(f) and elect to expense under Sec. 179(a) the cost (or a portion of the cost) of qualified real property placed in service by the taxpayer during any tax year beginning in 2010, 2011, 2012, or 2013 by filing an original or amended federal tax return. The notice also allows taxpayers whose 2010 through 2013 tax years are open under the Sec. 6501(a) statute of limitation to file amended returns to carry over unused Sec. 179 deductions for qualified real property to 2012 or 2013.

In addition, the notice describes in detail (including examples) how to allocate the amount of a taxpayer's unused Sec. 179 deduction between the amounts attributable to property that qualifies for the unlimited carryforward period and qualified real property, which cannot be carried forward indefinitely.

NOTED IN PASSING

■ **The IRS issued its annual update of special per diem rates effective Oct. 1, 2013, for use in substantiating certain business expenses** taxpayers incur when traveling away from home (Notice 2013-65). The notice provides rates for transportation industry meal and incidental expenses (\$59 for any locality of travel in the continental United

States and \$65 for any locality of travel outside the continental United States) and the incidental-expenses-only deduction (\$5 per day), as well as the rates and list of high-cost localities for purposes of the high-low substantiation method (\$251 for high-cost localities and \$170 for other localities in the continental United States). The notice also lists high-cost localities that have a federal per diem rate of \$210 or more.

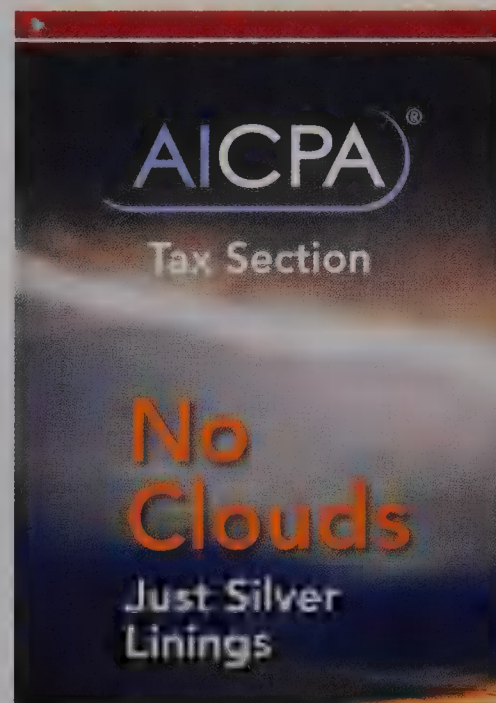
■ **The Supreme Court granted the government's petition to review the Sixth Circuit's decision in *Quality Stores, Inc.***, 693 F.3d 605 (6th Cir. 2012), that denied FICA taxability of employee severance payments (No. 12-1408 (U.S. 10/1/13) (*cert. granted*)). The Sixth Circuit in January 2013 split from the Federal Circuit's holding in *CSX Corp.*, 518 F.3d 1328 (Fed. Cir. 2008), that supplemental unemployment compensation benefits are subject to FICA tax.

REFUGE FROM TAX CLIENTS NONDEDUCTIBLE

A sole proprietor tax return preparer could not deduct travel expenses she claimed were necessary to get a good night's rest away from her clients, the Tax Court held (*Linzy*, T.C. Memo. 2013-219).

The preparer, Joyce Linzy, operated Joyce's Tax Service in her Illinois home. On her 2009 Schedule C, *Profit or Loss From Business (Sole Proprietorship)*, she deducted expenses for a hotel, car rental service, and casino, saying that because her clients called her at home at any hour, she had to travel "just to get rest" so that she "could function."

The Tax Court, noting that for purposes of business travel-related deductions, where a taxpayer lives—and by extension, getting a good night's rest—is a personal decision. The court also upheld the IRS's disallowance of other deductions, including for business use of her home and unsubstantiated gambling losses, and its imposition of an accuracy-related penalty. ♦



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STATE & LOCAL TAXES

Tenth Circuit Resurrects Colorado's Amazon Law

The Tenth Circuit Court of Appeals recently dismissed a lower court's permanent injunction that had enjoined Colorado from enforcing its Amazon law requiring remote sellers to report sales in the state. The Tenth Circuit held that the Tax Injunction Act (TIA) precludes federal jurisdiction over the claim that Colorado's law requiring out-of-state retailers to report information about customers' purchases to each customer and to the Colorado Department of Revenue (DOR) violates the Commerce Clause of the U.S. Constitution (*Direct Marketing Ass'n v. Brohl*, No. 12-1175 (10th Cir. 8/20/13)).

As a result, the Tenth Circuit remanded the case to the district court to dismiss the Commerce Clause claims and lift the permanent injunction the lower court had imposed prohibiting the DOR from enforcing the law (*Direct Marketing Ass'n v. Huber*, No. 1:10-CV-01546-REB-CBS (D. Colo. 3/30/12)). Any further proceedings in the case must begin in Colorado's courts or administrative agencies.

BACKGROUND

The Colorado law (Colo. Rev. Stat. §39-21-112(3.5)) and related regulations require any retailer that sells \$100,000 or more of products to customers in Colorado, but does not collect and remit sales taxes on those products, to:

- Notify the purchaser that the retailer does not collect Colorado sales tax and that the purchaser is therefore obligated to self-report and pay use tax.
- Send each customer who purchases more than \$500/year of products from the retailer an annual report of the prior calendar year's purchases and inform the customer that the retailer is required to file an annual purchase summary reporting the customer's name and total purchases to the DOR.
- Provide the DOR with an annual customer information report stating the name, billing and shipping address, and total purchases for each of its Colorado customers.

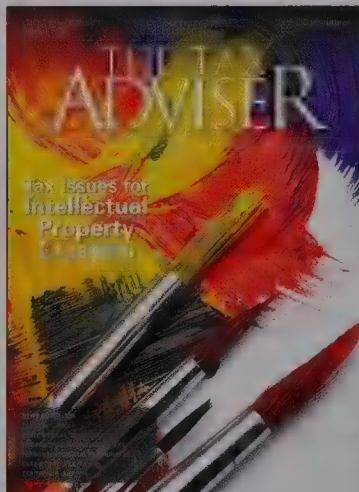
Retailers can avoid the reporting requirements by voluntarily collecting tax from customers in Colorado.

The lower court had found that the law violated the "dormant Commerce Clause" (the constitutional theory that prohibits state actions that interfere with interstate commerce) because it discriminates against out-of-state retailers by treating them differently from in-state retailers and was therefore invalid on its face. That court further held that the DOR had failed to overcome this finding of facial invalidity because it failed to prove that the law advances a legitimate local purpose that could not be served by "reasonable nondiscriminatory alternatives."

The TIA states that "district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State" (28 U.S.C. §1341). The Tenth Circuit characterized this as a broad jurisdictional barrier that prevents federal courts from interfering with the important state concern of collecting taxes.

For a detailed discussion of the issues in this area, see "Use Tax Reporting: Is Colorado Back in Business?" by Sarah McGahan, J.D., in the December 2013 issue of *The Tax Adviser*.

—Alistair M. Nevius, editor-in-chief
The Tax Adviser



thetaxadviser.com

Also look for articles on the following topics in the December 2013 issue of *The Tax Adviser*:

- A discussion of tax issues for creators of intellectual property.
- An update on employee benefits and compensation issues.
- An analysis of the five-year built-in gain recognition period.

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Technology Q&A

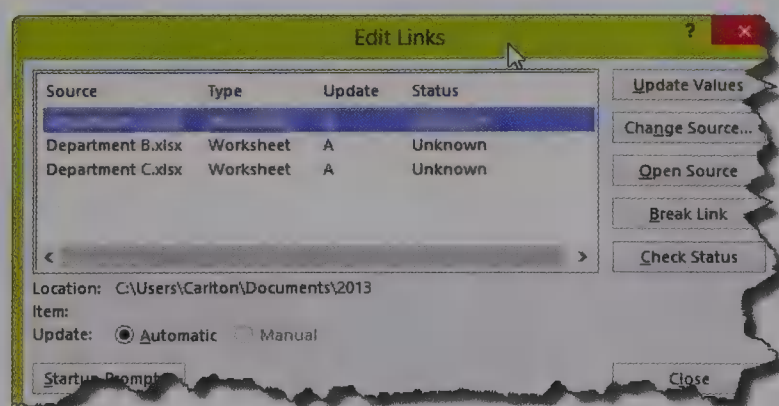
by J. Carlton Collins, CPA

LINK PRESERVATION

Q I have created a “digital dashboard” in an Excel workbook that summarizes information from multiple Excel workbooks. As long as I maintain the linked files on my PC, the links work perfectly. However, when I email the dashboard workbook and related linked workbooks to others, these links stop working for some but not for others. What are we doing wrong?

A To preserve links between workbooks, the resulting link paths and file names must be the same on the destination computer as on the origination computer; otherwise, Excel does not know where to look for the related linked files. Presented below are three suggestions:

1. **Use identical file paths.** Your links should continue to work correctly as long as your recipient saves the linked files using the same path and file name used when creating the links. For example, if the linked files were originally saved to **C:/Data Folder**, then your recipients should also save them to **C:/Data Folder** on their computers.
2. **Repair broken links.** Excel provides tools for repairing broken links. To use these tools, your recipients should open the dashboard workbook, and from the **Data** tab, select **Edit Links** to display the **Edit Links** dialog box, pictured below. (As each link is selected, the expected location of each linked workbook is displayed below the **Select** box. Clicking the **Check Status** button tests the link's validity, and if the link is broken, an error message is reported instead of the **Location**.)



To repair the link, select it and click the **Change Source** button, then navigate to the correct source file, and click **OK**, **Close**. Repeat these steps for each broken link, then resave the dashboard workbook.

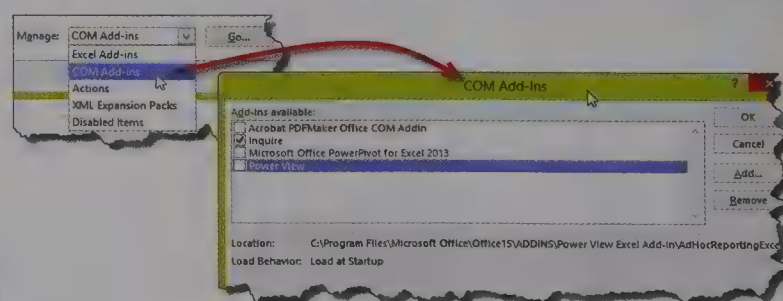
3. **Share files in the cloud.** Another approach to preserving links is to save files in the cloud via services such as Dropbox, Google Drive, iCloud, SharePoint Server, SkyDrive, etc. All parties can then access both the dashboard workbook (which contains the links) and the linked source files, without having to manage file locations or repair links. This approach offers the added advantage that the authors of the supporting source workbooks can update their information in the cloud and the resulting dashboard workbook can reflect their changes instantly (as links are refreshed), without having to constantly resend the linked source files to the recipients.

(Keep reading as the next topic describes new link management tools available in Excel 2013, which you may find helpful.)

INQUIRING MINDS

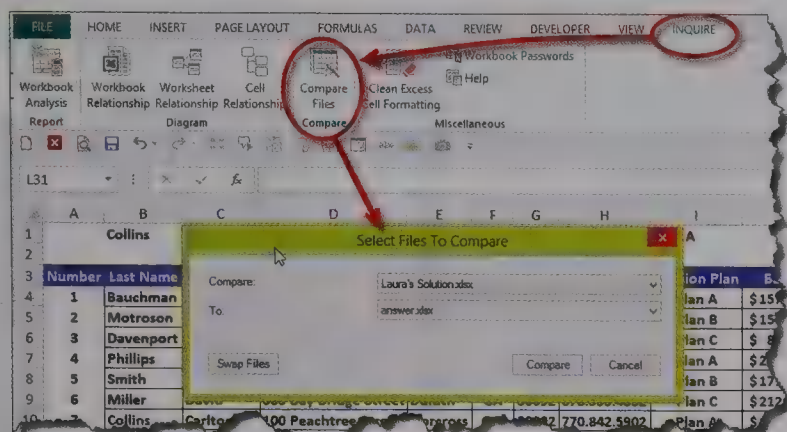
Q In your April 2013 *JofA* article titled “Microsoft Office 2013,” page 32, you mentioned that Excel 2013 offers the ability to “compare two spreadsheets to display changes (similar to Word’s **Compare** tool),” but I can’t find this functionality. Can you please tell me where to find this tool?

A To use Excel 2013’s new **Compare** tool, you must first activate the **Inquire** add-in from Excel’s **File** tab by selecting **Options, Add-Ins**. In the resulting **Excel Options** dialog box, from the **Manage** dropdown box in the lower-left corner, select **COM Add-ins** and click **Go**. In the resulting **COM Add-Ins** dialog box (pictured below), check the **Inquire** box and click **OK**.

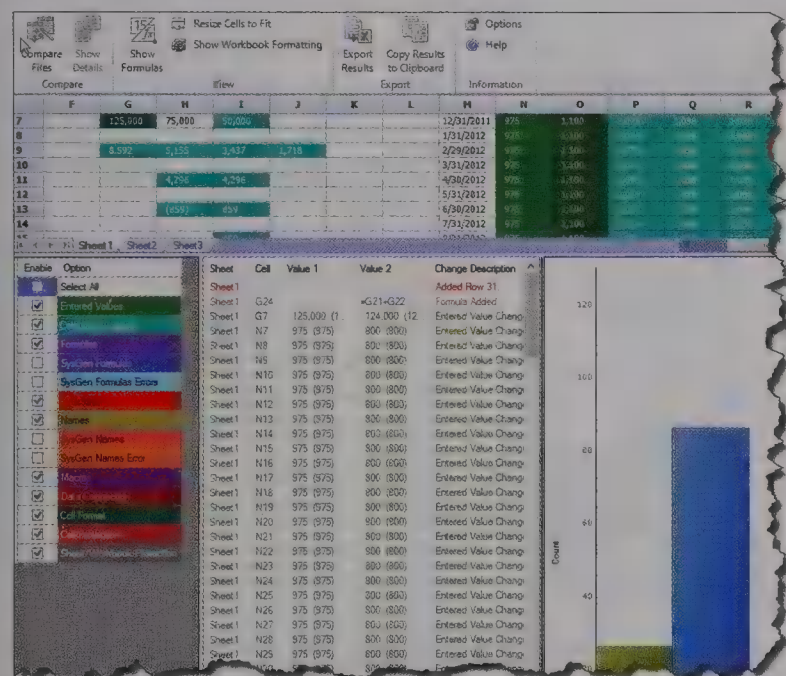


These steps enable and display the **Inquire** tab in the Excel 2013 Ribbon, as pictured in the first screenshot on the next page. Make sure the two files you want to compare are open; then from the **Inquire** tab, select **Compare Files**, choose the two files you want to compare from the **Compare** and **To** dropdown boxes, and then click the **Compare** button.

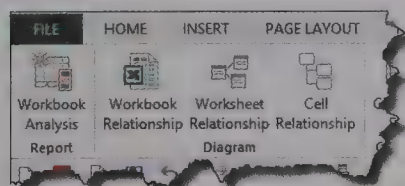
Excel compares and analyzes the selected files, displaying them side by side in a new interactive **Spreadsheet Compare** window



(a portion of which is pictured below). The cells that differ are highlighted and color-coded according to type (i.e., changed values, formulas, format, etc.). A separate window lists each changed cell address (along with descriptions of those changes), and a chart located in the lower-right corner summarizes the frequency of the types of changes detected. Additional windows summarize VBA code or macro changes line by line, when detected.

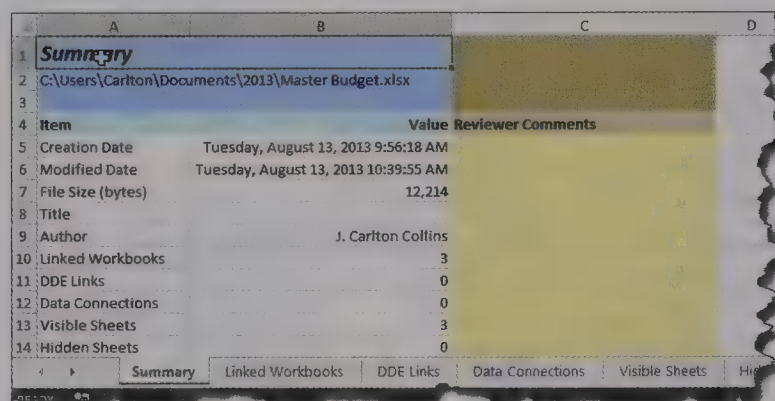


In addition to the Compare tool, the **Inquire** tab also includes four new analysis tools, described below:



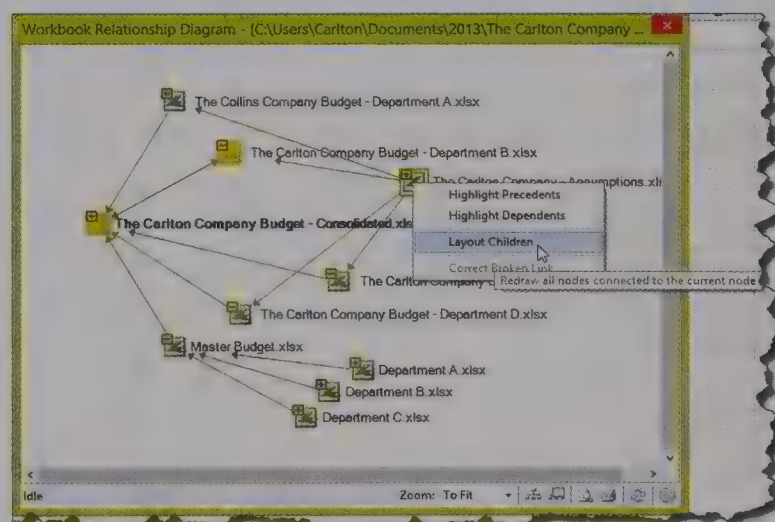
1. **Workbook Analysis.** To view a report detailing dozens of characteristics of a workbook, from the **Inquire** tab, select **Workbook Analysis** to launch the dialog box (pictured in the next screenshot in the background) and place a checkmark next to the characteristics you want to analyze. For example, you might choose to analyze warnings, errors, hid-

den items, or linked workbooks. After making your selections, click **Excel Export**, **Save**. In the resulting confirmation dialog box click **Load Export File** to view the summary report (pictured below in the foreground).



The first worksheet summarizes the analysis, and the worksheets that follow provide details for each analysis. This type of report might be useful to help analyze or better understand a complicated Excel file you did not author.

2. **Workbook Relationship.** To help manage workbooks with numerous connections, from the **Inquire** tab, select **Workbook Relationship** to display an interactive diagram of all related files, with arrows depicting the directional flow of links to those files.

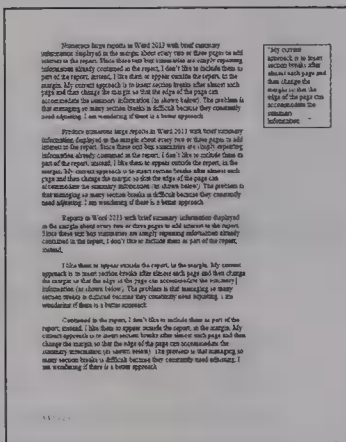


The nodes in the diagram can be drilled or rearranged as needed, and additional tools allow you to highlight precedent and dependent files, display parent/children layouts, and repair broken links. This diagram maps workbook links to multiple types of data sources, including workbooks, Access databases, text files, HTML pages, and SQL Server databases, to name a few.

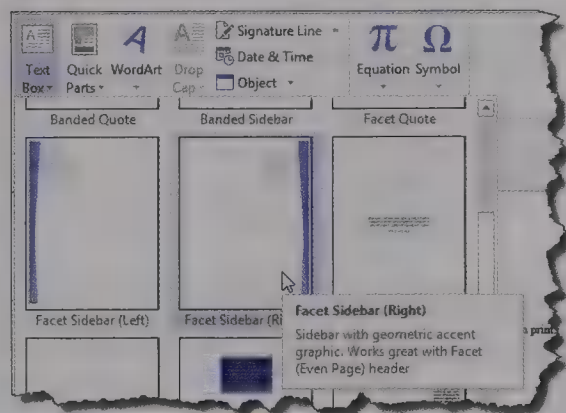
- 3&4. **Worksheet Relationship and Cell Relationship tools.** The **Inquire** tab's **Worksheet Relationship** and **Cell Relationship** tools work similarly to the **Workbook Relationship** tool but instead summarize links between sheets for a specific workbook, or links to a specific cell address.

SIDEBARS

QI produce large reports in Word 2013 with brief summary information displayed in the margins about every two or three pages to add interest to the report. Because these text box summaries are simply repeating information already contained in the report, I don't like to include them as part of the report; instead, I want them to appear outside the report area, in the page margins. My current approach is to insert section breaks after almost every page and then enlarge the margin so it can accommodate the summary information (as suggested in the thumbnail image at right). The problem is this creates numerous section breaks, and managing them becomes difficult because they constantly need adjusting as I add, delete, or move content. I am wondering if there is a better approach that I might be overlooking.

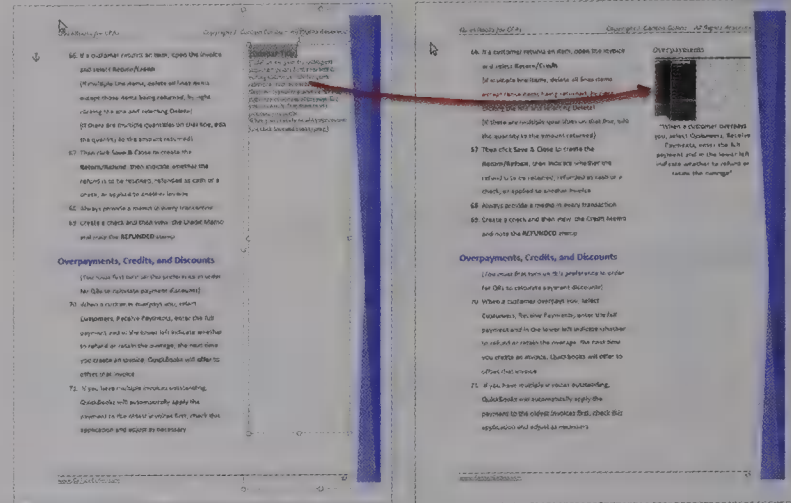


AThe inclusion of teaser information is an excellent way to draw readers into your reports, but I think you would be better off using Word's **SideBar Textbox** capabilities to achieve the results you desire. To create a professional-looking sidebar, from the **Insert** tab, select **Text Box** and scroll down to choose one of the 11 professionally designed sidebars (there are 35 built-in text boxes altogether, and more options are available on the web), such as the **Facet Sidebar (Right)** option pictured below.



These steps create a sidebar template on the current page, with text boxes, placeholder text, and artistic images grouped together and formatted with the proper page positioning and word wrapping needed to accommodate your teaser information.

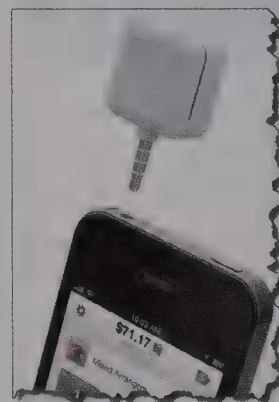
The sidebar's default word wrap settings allow text to flow freely from one page to the next without interference from section breaks, even if you add, delete, or move content. Additionally, if you find you need to move a sidebar from one page to the next, you can drag and drop it to the desired position (as shown in the next screenshot). This sidebar approach should prove faster and less cumbersome than your current approach.



LOUD & SQUARE

QI'm using a Square credit card reader that attaches to my smartphone, but I'm finding that the transactions don't always go through properly. Is there a certain smartphone or cellular service provider that works better with these devices, or should I be using a different smartphone credit card reader?

AThe solution may be as simple as turning up the volume on your smartphone. The Square Reader (as with similar devices) draws its power from the smartphone's audio port (standard 3.5mm headphone minijack), but if the smartphone's



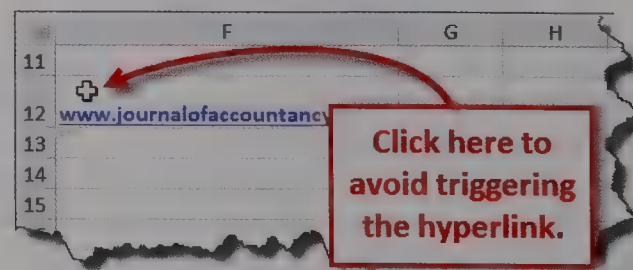
volume is too low, the device may not be receiving enough power to work correctly or consistently.

Many smartphone-based credit card readers are on the market; each has different fees and capabilities. This industry is growing fast, and these devices' plans and features are changing frequently. The brief comparison in the chart on the next page may help steer you toward the best option.

CELL SELECTIONS REACH NEW HEIGHTS

QIn Excel, is there a way to click on a cell containing a hyperlink without triggering the hyperlink? (Surely my current method of clicking next to the cell and then using arrow keys cannot be the best method.)

AMake the row height bigger or the column wider, then you can click in the white area of the cell to select it without triggering the hyperlink.



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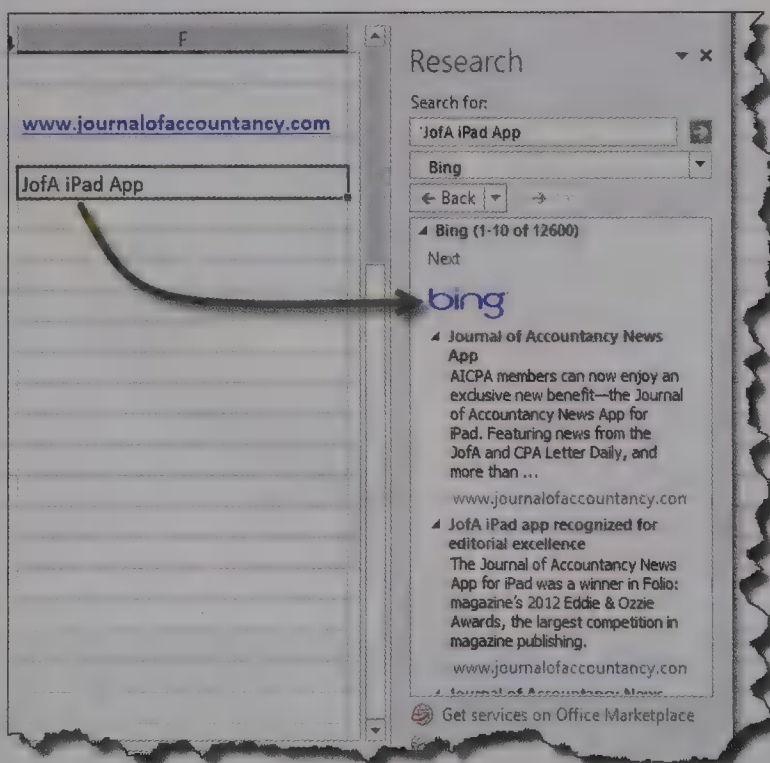
Smartphone Credit Card Readers Compared

(See "Loud & Square" on previous page. Data current as of September 2013.)

Selected Credit Card Readers	OS	Fees Per Transaction Based on Swiped Transactions	Fees Per Transaction Based on Keyed Transactions	Fees Based on Monthly Subscription Plan	Comments
Square Register (squareup.com)	iOS and Android	2.75%	3.50% + \$0.15	Flat rate of \$275/month	Allows you to print your business name and logo on the emailed receipt.
PayPal Here (tinyurl.com/6srtqq4)	iOS and Android	2.70%	3.50% + \$0.15	N/A	Funds are deposited into your PayPal account within minutes of the transaction, whereas most other options require one to three days.
PayAnywhere (payanywhere.com)	iOS, Android, and BlackBerry	2.69%	3.49% + \$0.19	N/A	Offers a \$10 rebate after completing your first swiped transaction.
Intuit GoPayment (tinyurl.com/mhpwcl7)	iOS and Android	2.75%	3.75%	\$12.95/month plus 1.75% (swiped), 2.75% (keyed)	Each account supports up to 50 users. Full refunds can be made on the spot; partial refunds require users to log in to the Intuit website. Uses geolocation sales tax calculations.
VeriFone (tinyurl.com/kks25uf)	iOS and Android	2.70%	3.70%	\$9.95/month plus 1.95% (swiped), 2.95% (keyed)	Also allows you to sync your inventory item quantities across different mobile devices or through its website as sales are made or items are received.
Phone Swipe (phoneswipe.com)	iOS, Android, and BlackBerry	2.69%	3.49% + \$0.19	N/A	Employs the Geo Tax system, which automatically calculates the sales taxes based on your location.
Groupon Breadcrumb (tinyurl.com/myk3zog)	iOS	1.80% + \$0.15 (3.50% AMEX)	2.30% + \$0.15	N/A	Groupon offers the lowest rates, but it currently works only with the iPhone or iPad.

EXCEL QUICK TIP

Holding down the Alt key and clicking on any cell triggers a Bing search based on the contents of that cell. The results are displayed

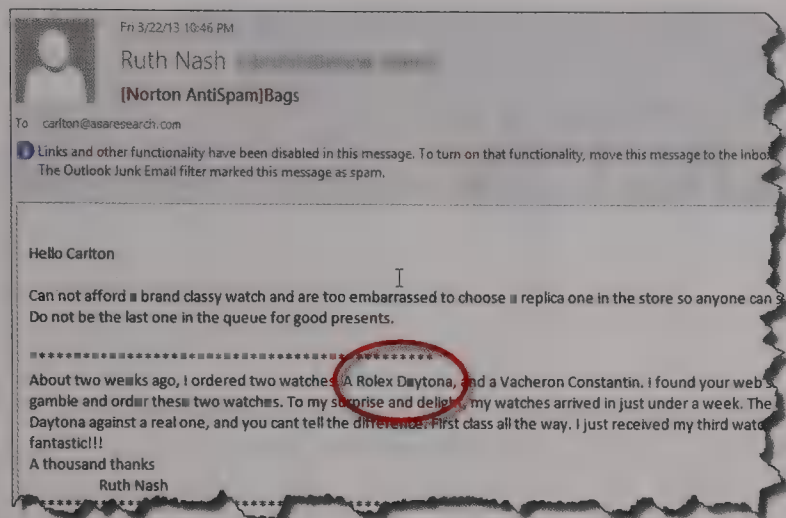


automatically in a pop-up **Research** side panel. Give it a try. (**Note:** For this to function properly, you may need to first adjust the **Research** panel's options by selecting the dropdown box at the top of the **Research** panel and selecting **Bing**).

READER CHALLENGE: PRIVACY TEST

In the aftermath of so many revelations about computer privacy this year, I thought it might be interesting to put your own privacy to the test. Earlier this year I found myself shopping for camping tents on Amazon.com, but I did not make a purchase. Shortly thereafter, I noticed that the camping tents I had studied for a longer time began showing up in banner ads in various websites, and even in ads along my Facebook wall. I wasn't shocked to see this because I am well aware that a multitude of cookies pay close attention to my web surfing habits and target me accordingly.

This observation prompted me to conduct a more dramatic test in which I sent my wife an email message (using all of my active email accounts) stating that "I was thinking about purchasing a Rolex watch for our son on his birthday," and I then waited to see if Rolex watches were mentioned in any website banner ads. To my amazement, I started receiving junk email messages promoting Rolex watches, an example of which is shown on the next page.



I've often preached that you should assume 1,000 people are reading each email message you send or receive, because all of your unencrypted email messages (along with any unencrypted attachments) are vulnerable to peering hackers. This email may offer proof that at least one person is harvesting and exploiting my emails.

So here's the privacy test I propose: Send an email mentioning a retail item (preferably an item not normally associated with you), and then pay attention to your banner ads and junk email mes-

sages for a week to see if that item is mentioned in any of your emails or webpage banner ads. The results you see may provide clues as to your level of personal privacy. If you care to share those results with others (no matter the outcome), post them on this website that I created to capture your results: tinyurl.com/n7s99ws. (You may submit results anonymously.) I will compile the results and post them on this same website. ♦

J. Carlton Collins (carlton@asaresearch.com) is a technology consultant, CPE instructor, and a JofA contributing editor.

Note: Instructions for Microsoft Office in "Technology Q&A" refer to the 2013, 2010, and 2007 versions, unless otherwise specified.

Submit a question

Do you have technology questions for this column? Or, after reading an answer, do you have a better solution? Send them to jofatech@aicpa.org. We regret being unable to individually answer all submitted questions.



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- Public companies
- Large private companies
- Public practice who serve public or international companies with audit, preparation, or advisory services

Inside AICPA

INSTITUTE HOSTS 2013 LEADERSHIP ACADEMY CLASS

The AICPA's fifth annual Leadership Academy was held Sept. 29 to Oct. 3 in Durham, N.C.

During the five-day program, the 37 participants—all under age 36—learned leadership theory and strategic planning techniques while developing tools for handling complex management challenges. They also discussed pressing issues facing CPAs and the accounting profession with some of the profession's most influential leaders, including AICPA then-Chairman Richard Caturano and AICPA President and CEO Barry Melancon.

This year's attendees were selected from more than 120 candidates recommended by their employers, state CPA societies, or both. Candidates submitted résumés that included work history, licensure information, professional volunteer activities, community service, awards and honors, and a statement explaining why participating in this year's academy would be personally significant.

The members of the 2013 Leadership Academy class are:

- Mohamad Al-kawafha, PKF, Houston
- Chad Allen, Acord Cox & Co., Lenexa, Kan.
- Tracy M. Allen, AKT LLP, Lake Oswego, Ore.
- Victor A. Amaya, ClearPath Accountants LLC, Littleton, Colo.
- Jaclyn T. Badeau, Tempur Sealy International, Lexington, Ky.
- Jennifer J. Brown, GSC Agribusiness, Carroll, Iowa
- Tessa Carr, Arnett Foster Toothman PLLC, Charleston, W.Va.
- Erik M. Causey, KPMG LLP, Washington, D.C.
- Harris Darver, McGregor & Co. LLP, Columbia, S.C.
- Christine DeAngelis, Cobalt Benefits Group LLC, Exeter, N.H.
- Michelle B. Dooley, ThyssenKrupp Steel USA, Calvert, Ala.
- David M. Finklang, Anders CPAs + Advisors, St. Louis
- Kathryn M. Fletcher, Draffin & Tucker LLP, Atlanta
- Misty L. Geer, Halliburton Energy Services, Lafayette, La.
- Amber K. Goering, Amber K. Goering CPA PA, Olathe, Kan.
- Dena Jackson Lester Harrison, Protiviti, Orlando, Fla.
- Jason H. Hunter, Mantyla McReynolds, Salt Lake City

- Curtis M. Johnson, Mutual of Omaha, Omaha, Neb.
- Brett J. Jordan, Russell Investments, Seattle
- Heather N. Lenardson, Lenhart, Mason & Associates LLC, Casper, Wyo.
- Rachel K. Lloyd, Emdeon Inc., Nashville, Tenn.
- Satyasomeswar Maruvada, PwC LLP, Raleigh, N.C.
- Elizabeth N. Mason, BeachFleishman PC, Phoenix
- Joe L. Navarro, City of Bakersfield, Bakersfield, Calif.
- Joshua Norris, Corkern & Norris PLLC, Jackson, Miss.
- Elizabeth S. Pittelkow, ArrowStream Inc., Chicago
- Iralma Pozo, Bronx Overall Economic Development Corp., New York City
- Toby Ralston, StoneTurn Group, Boston
- Joseph M. Rugger, Jonesboro Prosthetic & Orthotic Lab, Jonesboro, Ark.
- Kala O. Sharp, ONEOK Inc. and ONEOK Partners LP, Tulsa, Okla.
- Kelly M. Sics, Wisconsin Dental Association, West Allis, Wis.
- Scott Smith, Smith, Kunz & Associates PLLC, Rexburg, Idaho
- Justin Thomsen, Muckel Anderson CPAs, Reno, Nev.
- Jeff W. Wilson II, National Credit Union Administration, Alexandria, Va.
- Jayme Woehl, Array Services Group Inc., Sartell, Minn.
- Mary Yeager, University of Cincinnati, Cincinnati
- David Zuidema, Dennen Steel Corp., Grand Rapids, Mich.

EDUCATORS RECOGNIZED FOR INNOVATIVE TEACHING PRACTICES

The AICPA announced the winners of the annual accounting curriculum awards, which are given to educators who have demonstrated innovative teaching practices in one of three distinct educational levels: in the first sequence of accounting, in junior- and senior-level accounting courses, and at the graduate level.

Markus Ahrens, professor of accounting at St. Louis Community College, received the 2013 Bea Sanders/AICPA Innovation in Teaching Award for the first sequence of accounting. Ahrens was recognized for implementing greater teamwork and student collaboration within the classroom, resulting in increased attendance, improvement in student grades, and

higher overall student success rates.

Marion E. McHugh, assistant professor in the Business and Accounting Department at Furman University, and Paul Polinski, lecturer of accountancy at the University of Illinois at Urbana-Champaign, received the 2013 George Krull/Grant Thornton Innovation in Teaching Award for junior- and senior-level accounting courses. Their winning curriculum centered on a project that engaged students' critical thinking about the appropriate separation of duties in the purchases and disbursements transaction cycles.

Jennifer Butler Ellis, Mark E. Riley, and Rebecca Toppe Shortridge of Northern Illinois University received the 2013 Mark Chain/FSA Innovation in Teaching Award for graduate-level accounting

teaching practices.

Their Master of Accounting Science program incorporated a

workshop to en-

sure graduates had not only technical accounting knowledge but also leadership and communications skills.

The winners' curricula, along with those of past winners, are included in the AICPA's Accounting Professors' Curriculum Resource, a tool for accounting faculty and students. (Access to the tool is limited to AICPA members.)

The AICPA, the Federation of Schools of Accountancy, and Grant Thornton will cover the winners' travel expenses to the 2014 American Accounting Association annual meeting, where the winners will present their curricula in person and receive their awards.

The award winners are selected by the AICPA Pre-certification Education Executive Committee, which assists the academic community in preparing students with the core competencies needed for entry into the profession.

PROGRAM COMBINES SCHOLARSHIPS WITH COMMUNITY SERVICE AND LEADERSHIP SKILLS

The Institute awarded more than \$370,000 in scholarships to 117 undergraduate and graduate students through its AICPA Legacy Scholars program.

AICPA Legacy Scholars are Student Affiliate Members (a free AICPA membership option available to all

students) who have received a one-year AICPA scholarship and will continue to receive benefits beyond their academic careers through the AICPA Legacy Scholars Alumni.

The program, which was established in 2011, consists of

recipients of three AICPA scholarships for the 2013–2014 academic year:

- AICPA/Accountemps Student Scholarship, awarded to 10 students for a total of \$25,000;
- AICPA John L. Carey Scholarship, awarded to 10 students for a total of \$50,000; and
- AICPA Scholarship for Minority Accounting Students, awarded to 97 students for a total of \$296,500.

As AICPA Legacy Scholars, students must perform eight hours of community service per semester. They may select their own community service activity and are encouraged to be as creative as possible, as long as the activity relates to accounting, serves the community, and is meaningful to the student.

As part of the application process, students are asked to write an essay describing their intended service project.

Once students are selected, the AICPA provides guidance on how the students can best execute their service activity, helping to ensure that they gain the maximum value for their time and effort.

Also, each AICPA Legacy Scholar receives a coach who provides guidance on the student's service project and serves as an adviser for questions related to the profession and the work environment. Recipients have a dedicated, exclusive interactive community of their peers on ThisWayToCPA.com, where they can access resources to assist in their service project.

For more information on AICPA scholarships, visit ThisWayToCPA.com.

INSTITUTE NAMES NEW DIRECTOR FOR CONGRESSIONAL & POLITICAL AFFAIRS TEAM

Rachel Dresen is a new director on the Institute's Congressional & Political Affairs team.

She joins the AICPA from the staff of Rep. Ron DeSantis, R-Fla., where she was legislative director and had primary responsibility for issues related to his service on the House Judiciary Committee.

From 2011 to 2013, Dresen served as legislative director for former Rep. Ben Quayle, R-Ariz.

Prior to that, she

was a legislative assistant for former representatives Jeff Flake, R-Ariz., and Chris Cannon, R-Utah, and was a researcher for the National Republican Congressional Committee.

The accounting curriculum winners will present their curricula at the 2014 American Accounting Association annual meeting in Atlanta.

AICPA Legacy Scholars must perform eight hours of community service per semester.

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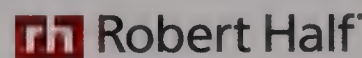
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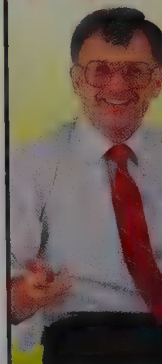
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THE LAST WORD

My oldest son, Will, who is a student at Vanderbilt University, got involved with The Belize Project based in Nashville.

He went to Belize a couple of spring breaks and did some projects. One of the projects was building irrigation systems and structures at a drug and alcohol rehabilitation center called Jacob's Farm. When he shared with our family that a lot of work had been done at the farm over the years and the road to the farm had gotten washed out due to a storm, we got together some financial support to help get the road to Jacob's Farm rebuilt. That's what set me on the road to going to Belize and meeting the people at the farm and helping them with their financial reporting and bookkeeping, so they could apply for grants from the government of Belize. Then that led me to the schools down there that had similar needs.

These are schools sponsored by the Presbyterian Church in Belize. The elementary school in Belize where I was working, which is called New Life, has 250 students and is in Orange Walk, a town of about 15,000. The typical middle school would have 125 students, and the high school, Cornerstone High School, has about 110 students.

They didn't have any systems in place. To apply for government grants, they have to show how many students are enrolled, what their current tuition is, what their current salaries and direct expenses of running the schools would be on a monthly and annual basis, and they weren't really able to do that. One month it would be one way, the next month it would be another way. It was incomplete. They were trying to keep up with tuition manually. Some students pay, some don't. Some students qualify for government funding, some don't. There are some subsidies. The more I got into it, the more I realized that these are not easy accounting questions. So I understood why they were struggling.

The project started in 2012. I spent some time with Mac Kelton, the director of the Belize Project, and we had some conference calls with the general manager of the schools in Belize. We started strategizing how we would try to get all the schools on a more standardized financial reporting system, which meant we also had to help them create an accounting system and work flow and so forth. We did some advance work putting the structure in place and gathering all the raw data and then building the charts of accounts.

We did some fundraising through the Alabama Society of CPAs and were able to buy computers, printers, QuickBooks software, training

manuals, and office supplies. Last December, I traveled to Belize with Will and my son Andrew, a freshman at Auburn University, and spent a week doing training for 12 people from the various schools and from the general manager's office on basic bookkeeping, accounting, financial reporting, and QuickBooks. We left all the hardware, computers, software, everything with them to use and said, "Work with this. Let me know what questions you have. I'll be back."

In August, I went back to Belize and this time worked with about 10 people from the schools and the general manager's office and sat down one-on-one getting all actual, live data input into QuickBooks and all their budgets. By the time I finished that week, they were all up and running on QuickBooks with their budgets and current information, ready to start the new school year.

I think the best thing I got out of it was just the experience of being able to leave the state of Alabama and go and apply the skills that I use every day, in another country, and that would really help the people there and have an immediate impact on their lives. Learning to work through some of the adversities down there and the challenges of being in another country, another culture, I think will make me a better CPA.

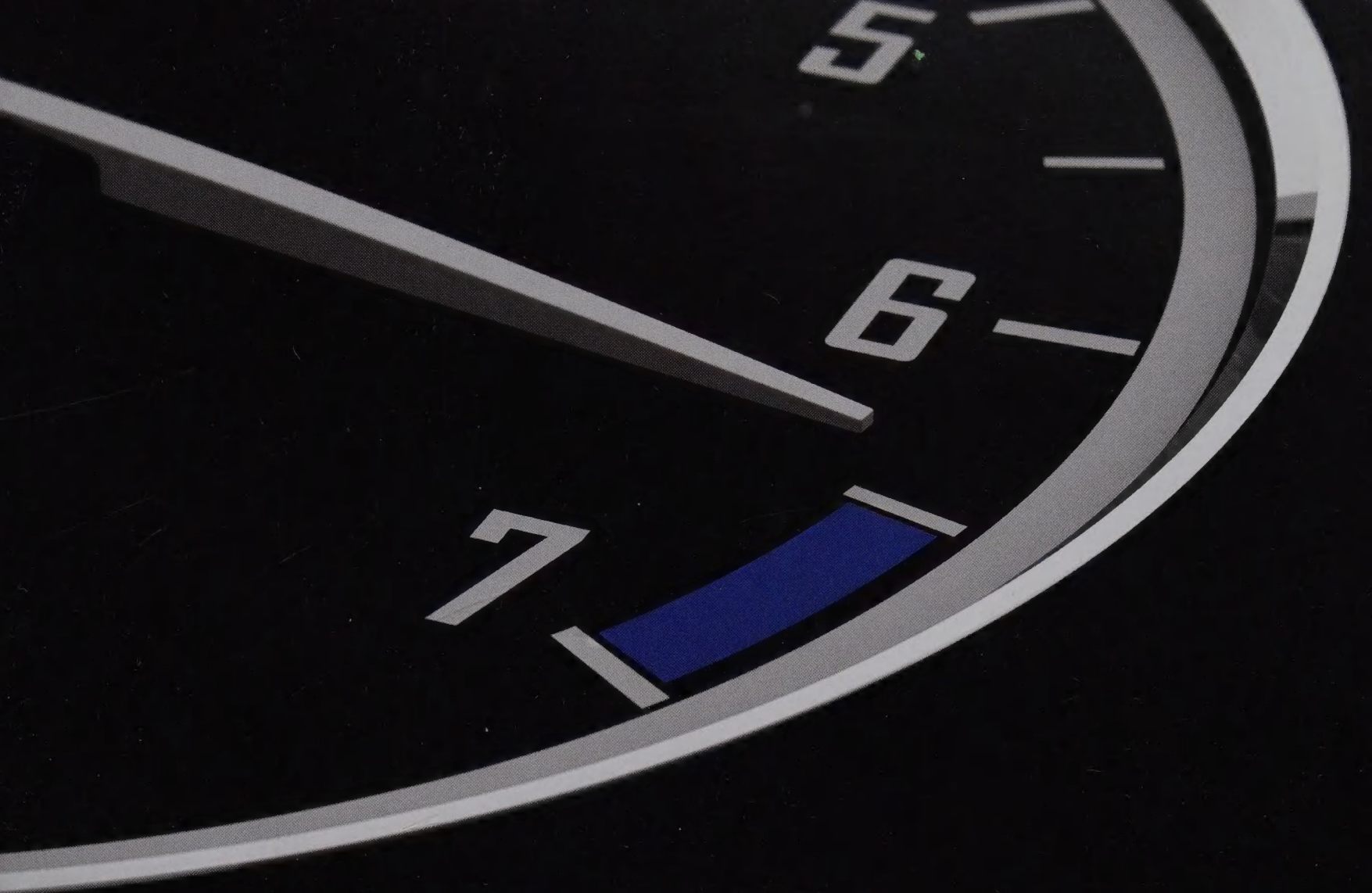
—As told to Sabine Vollmer, svollmer@aicpa.org,
a JofA senior editor.

Ron Stokes, CPA/PFS, CGMA

Ronald W. Stokes CPA PC

Birmingham, Ala., pictured in Orange Walk, Belize, with Ruth Ku (standing), principal of New Life Elementary School, and Dalila Mendez, a financial assistant and teacher.





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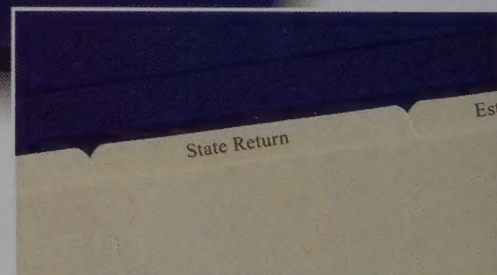
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